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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 436

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 14, 1940
CERTIORARI GRANTED NOVEMBER 12, 1940

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June 2, 1939. Motion for extension of 15 days to file brief filed by General Counsel.
June 16, 1939. Motion for extension to June 30, 1939, to file brief filed by taxpayer.
June 17, 1939. Motion for extension to June 30, 1939, to file brief filed by General Counsel.
3 June 29, 1939. Stipulation to correct the transcript and for extension to June 30, 1939, to file briefs, filed.
July 5, 1939. Motion of June 16, 1939, granted.
July 5, 1939. Brief filed by taxpayer. 7/12/39 copy served on General Counsel.
July 10, 1939. Brief lodged by General Counsel.
July 12, 1939. Motion of June 17, 1939, granted.
July 25, 1939. Reply brief lodged by General Counsel.
July 25, 1939. Motion for leave to file the above brief filed by General Counsel. 7/29/39 granted.
Aug. 28, 1939. Memorandum opinion rendered. John E. Murdock, Div. 3. Decision will be entered under Rule 50.
Nov. 21, 1939. Decision entered, J. E. Murdock, Div. 3.
Nov. 25, 1939. Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer.
Nov. 25, 1939. Præcipe for record filed by taxpayer.
Dec. 6, 1939. Proof of service of filing petition for review and præcipe filed.
Jan. 20, 1940. Agreed statement of evidence, stipulation of facts lodged.
Jan. 20, 1940. Agreed statement of evidence, stipulation of facts approved and ordered filed.
Jan. 20, 1940. Agreed præcipe for record filed.
Jan. 22, 1940. Order extending time to February 1, 1940, for transmission and delivery of the record, entered.

4 Before United States Board of Tax Appeals

Docket No. 93754

JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, AS EXECUTORS OF THE ESTATE OF JOHN M. ENRIGHT, DECEASED, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed May 24, 1938

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of In-

ternal Revenue in his notice of deficiency IT:B:1 UVT-90D, dated March 5, 1938, and, as a basis of their proceeding, allege as follows:

(1) Petitioners are the executors under the last will and testament of John M. Enright, who died a resident of Freehold, New Jersey, November 19, 1934.

Their address for the purpose of this proceeding is with the firm of McDermott, Enright & Carpenter, 75 Montgomery Street, Jersey City, N. J.

(2) The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioners, dated March 5, 1938.

(3) The tax in controversy is an income tax for the taxable year ended December 31, 1934.

The amount of the alleged deficiency is $16,250.52, all of which is in controversy.

(4) Prior to November 19, 1934, John M. Enright, James D. Carpenter, Jr., Howard C. Gilmour, Carl S. Kuebler and Patrick A. Dwyer were partners engaged in the practice of the law at 75 Montgomery Street, Jersey City, New Jersey, under the firm name of McDermott, Enright & Carpenter.

On November 19, 1934, John M. Enright, senior member of said firm, died testate, and said partnership, by reason of said death, forthwith dissolved.

As of the following day the surviving partners formed a new partnership under the firm name of McDermott, Enright & Carpenter, practicing law at the same address.

On said date the assets of the firm of McDermott, Enright & Carpenter consisted of:

(1) cash on hand available for distribution;

(2) accounts receivable on bills already rendered clients;

(3) pending cases in which some work had been done and on which additional work had to be done before the amount of fees to be charged could be determined and the cases billed to clients.

(5) At and prior to the date of Mr. Enright's death, his interest in the net earnings of McDermott, Enright & Carpenter was 34½ percent thereof.

(6) For the purposes of making and filing the Federal estate tax return and the New Jersey transfer inheritance tax return, the senior surviving partner of the firm of McDermott, Enright & Carpenter made a determination of the value of Mr. Enright's interest in the firm at the date of death, and his determination was as follows:

Interest of decedent in the firm income received to date of death (from the date of the last accounting, October 4, 1934)	$4,143.81
Interest of decedent in outstanding accounts receivable	2,055.55
Interest of decedent in estimated value of work in process	40,855.77
	47,055.13

6 In the income tax return filed by your petitioners as executors of decedent, for the year 1934, your petitioners included said item of $4,143.81 as income accrued to the date of death.

The remainder of $42,911.32 was nothing more than the estimated value for estate tax purposes of Mr. Enright's interest in the accounts receivable of the dissolved firm and the estimated value for such purposes of decedent's interest in the unfinished law business that was in the office at the time of dissolution of the firm.

(7) Petitioners further allege that the firm of McDermott, Enright & Carpenter had nine matters pending in the office as of the date of Mr. Enright's death, on which work was being done on a fixed fee basis and Mr. Enright's share of the amounts earned in said matters to the date of his death was $1,024.89, which amount is included in said sum of $42,911.32. In none of such matters, however, were the fees payable at the date of death but they were payable on a per month or per annum basis at future dates.

(8) Petitioners further show that all the remaining business of the firm was being handled on the basis of the firm being paid a reasonable fee for the work done, taking into account the results accomplished and the time and effort devoted to the cases. The amounts ultimately realizable in such cases largely depended upon the skill with which the work, after the date of death, was done and the resulting success that might be obtained.

(9) Petitioners further show and charge that while the above amount of $42,911.32 was estimated for the purposes of the Federal estate tax return and the New Jersey inheritance tax return as the value of decedent's interest in the firm as of the date of death, actually the liquidation of the assets of the firm of McDermott, Enright & Carpenter, including pending cases, has resulted in the following amounts being collected for and

7 paid to your petitioners by McDermott, Enright & Carpenter, new firm, from liquidation of the business of the old firm:

November 19, 1934, to December 31, 1934	$5,497.15
For the calendar year 1935	24,942.52
For the calendar year 1936	6,793.39
For the calendar year 1937	5,578.51
January 1, 1938, to May 16, 1938	2,068.53
	44,880.10

(10) Petitioners further show and charge that of the estimated value of the accounts receivable, $5,958.12, there is still uncollected $1,460.04, some of which may not be collected.

(11) Petitioners further show that there are still forty-eight cases that were in the office on the date of Mr. Enright's death that still remain to be concluded, from which, if concluded successfully, your petitioners will have a further interest.

(12) Petitioners are informed by the new firm of McDermott, Enright & Carpenter that they confidently believe that decedent's interest in the old firm will ultimately liquidate at in excess of $46,000 instead of the estimated sum of $42,911.32.

(13) Your petitioners further show and charge that the alleged deficiency asserted in this case arises because the Commissioner erroneously has redetermined decedent's income for the year 1934 by adding to the gross income of said year said sum of $42,911.32 as income accrued to the date of death.

(14) Decedent, John M. Enright, filed his income tax return on the cash basis.

(15) Petitioners allege that said redetermination is erroneous for the following reasons:

(1) Said sum was not in fact income accrued to the date of death.

8 (2) Decedent's interest in the outstanding accounts receivable of the old firm of McDermott, Enright & Carpenter, as of the date of death, was not income accrued to decedent until the bills rendered on the outstanding accounts were paid and the money received by McDermott, Enright & Carpenter, and when such bills were paid to said firm, then, for the first time, income may be said to have accrued to the extent of the interest of Mr. Enright in the amounts paid.

(3) Decedent's interest in the unfinished business of the firm as of the date of death was not income accrued either to the firm or to decedent as a member thereof, for the following reasons:

(a) Nine matters in the office were being handled on a fixed fee basis and the total amount of the interest of John M. Enright therein earned to the date of death was $1,024.89. In none of such matters were the fees payable at the time of death, but they were payable on a per month or per annum basis at future dates.

(b) All of the remaining business of the firm was being handled on the basis of the firm being paid a reasonable fee for the work done, taking into account the results accomplished and the time and effort devoted to the cases. The amounts ultimately realizable in such cases largely depended upon the skill with which the work, after the date of death, was done and the success that might be obtained.

(c) Had a successor firm not been formed which took over and liquidated the business of the old firm, the amount that could have been collected for the work done to the date of the dissolution of the old firm would have been a mere fraction of the amount ultimately collected.

(15) Petitioners did not sell the interest of the decedent, John M. Enright, in the firm, to the surviving partners or anyone else, but they have been paid from time to time the interest of John M. Enright in the business of the old firm as it has been gradually liquidated. Liquidation will not be completed for another year or more.

9 (16) Petitioners further show and charge that they paid Federal estate taxes on the basis that decedent's interest in the firm of McDermott, Enright & Carpenter, as of the date of death, was worth $42,911.32, and that it would be unfair and unjust that they should, in addition, pay income taxes on the whole of said sum for the year in which he died as though it were income accrued to the date of death.

(17) Petitioners aver that if it should be determined by this Board that said sum of $42,911.32 should be added to decedent's gross income for the calendar year 1934, and they should be compelled to pay the tax under review, it will then necessarily follow that petitioners overvalued decedent's interest in the firm in filing their Federal estate tax return, and, in such event, they will claim that decedent's interest in the firm of McDermott, Enright & Carpenter was actually worth not $42,911.32, but such amount less the income tax thereon, or, in the alternative, that there should be allowed as a deduction against the gross estate the amount of the deficiency of income taxes for 1934, from which this appeal is taken, and they pray the right of recoupment accordingly.

Wherefore, petitioners pray that this Board may hear the proceeding and set aside and vacate the determination of income tax liability made by the Commissioner of Internal Revenue set forth in the notice hereto annexed, and that petitioners may have such other relief as may be proper.

JAMES G. ENRIGHT,
EMMA E. NEILSON,
MILDRED L. ENRIGHT,
Executors of the Estate of John M. Enright, Deceased, Petitioners.

JAMES D. CARPENTER, JR.,
Counsel for Petitioners,
75 Montgomery Street, Jersey City, N. J.

10 [*Duly sworn to by James G. Enright et al.; jurat omitted in printing.*]

Know all men by these presents, that we, James G. Enright, Emma E. Neilson, and Mildred L. Enright, executors under the last will and testament of John M. Enright, deceased, hereby constitute and appoint James D. Carpenter, Jr., and/or Elmer J. Bennett as our attorneys to prosecute all tax matters in relation to the estate of John M. Enright, deceased, before the United States Board of Tax Appeals.

In witness whereof, we have hereunto set our hands and seals this twenty-third day of May 1938.

JAMES G. ENRIGHT, [LS]
EMMA E. NEILSON, [LS]
MILDRED L. ENRIGHT, [LS]
Executors of the Estate of John M. Enright, Deceased.

Signed, sealed, and delivered in the presence of:

ALICE M. BOYLE.

11 *Exhibit A to petition*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Mar. 5, 1938.

Address Reply to Commissioner of Internal Revenue and Refer to Mr. James G. Enright et al., Executors, Estate of John M. Enright, Deceased, 75 Montgomery Street, Jersey City, New Jersey.

SIRS: You are advised that the determination of the income tax liability of John M. Enright, deceased, for the taxable year ended December 31, 1934, discloses a deficiency of $16,250.52, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:Cl:P-7. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of inter-

12 est, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By W. T. SHERWOOD,
Acting Deputy Commissioner.

Enclosures:
Statement.
Form 870.

STATEMENT

IT:B:1
UVT-90D

Mr. James G. Enright et al., Executors, Estate of John M. Enright, Deceased, 75 Montgomery Street, Jersey City, New Jersey.

Tax liability for Taxable Year Ended December 31, 1934

Income Tax: Liability, $22,537.88. Assessed, $6,287.36. Deficiency, $16,250.52.

In making this determination of the income tax liability of John M. Enright, deceased, careful consideration has been given to the internal revenue agent's report dated October 28, 1936; to the protests dated December 16, 1936, April 15, 1937, April 27, 1937, and June 9, 1937; to the statements made at the conference held on April 15, 1937; and to the claim for refund filed on November 21, 1935.

If a petition to the United States Board of Tax Appeals is filed against the deficiency proposed herein, the issue set forth in your claim for refund should be made a part of the petition to be considered by the Board in any redetermination of the tax liability. If a petition is not filed, the claim for refund
13 will be disallowed and official notice will be issued by registered mail in accordance with section 1103 (a) of the Revenue Act of 1932.

A copy of this letter has been mailed to your representative, Mr. James D. Carpenter, Jr., 75 Montgomery Street, Jersey City, New Jersey, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return	$39,295.31
Unallowable deductions and additional income:	
(a) Interest	961.67
Net income as disclosed by revenue agent's report dated July 27, 1936	40,256.98
(b) Income from partnership of McDermott, Enright, and Carpenter	42,911.32
Total	83,168.30
Nontaxable income and additional deductions	None
Net income adjusted	83,168.30

EXPLANATION OF ADJUSTMENTS

(a) Interest accrued on bonds in the amount of $961.67 was omitted from income. This amount has been included in accordance with section 42-1, Regulations 86, Revenue Act of 1934. (Additional tax of $267.62 on this amount paid to collector.)

(b) The indicated amount, $42,911.32, has been included in the gross income of the decedent as income accrued up to the date of his death, under the provisions of section 42 of the Revenue Act of 1934, the said amount representing the decedent's share of fees earned or partially earned by the old firm of McDermott, Enright, and Carpenter up to the date of his death as determined by Mr. James D. Carpenter, the surviving senior member of the firm.

14 COMPUTATION OF TAX

Net income adjusted		$83,168.30
Less:		
Personal exemption		1,000.00
Balance (Surtax net income)		82,168.30
Less:		
Interest on Liberty bonds	$156.32	
Dividends	3,382.54	
Earned income credit	1,400.00	
		4,938.86
Net income subject to normal tax		77,229.44
Normal tax at 4% on $77,229.44		3,089.18
Surtax on $82,168.30		19,475.74
Total tax		22,564.92
Less: Income tax paid at source		27.04
Correct income tax liability		22,537.88
Income tax assessed:		
Original, account #March, 230179, 1935	$6,019.74	
Additional, account #September 51146, 1936 list	267.62	
		6,287.36
Deficiency of income tax		16,250.52

15 Before United States Board of Tax Appeals

Amended answer

Filed May 3, 1939

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

(1) and (2). Admits the allegations contained in paragraphs (1) and (2) of the petition.

(3) Admits that the taxes in controversy are Federal income taxes for the year ended December 31, 1934, as alleged in paragraph (3) of the petition, but denies all other allegations contained in said paragraph.

(4) Admits that prior to November 19, 1934, John M. Enright, James D. Carpenter, Jr., Howard C. Gilmour, Carl S. Kuebler, and Patrick A. Dwyer were partners engaged in the practice of the law at Jersey City, New Jersey, under the firm name of McDermott, Enright & Carpenter, and that on November 19, 1934, John M. Enright died as alleged in paragraph (4) of the petition but denies all other allegations of fact contained in said paragraph.

(5) to (14), inclusive. Denies the material allegations of fact contained in paragraphs (5) to (14), inclusive, of the petition.

(15)—(1) to (3), inclusive. Denies that the respondent erred as alleged in subparagraphs (1) to (3), inclusive, of paragraph (15) of the petition.

(15) (page 6). Denies the material allegations of fact contained in the second paragraph bearing No. (15) and appearing on pages 6 and 7 of the petition.

(16) and (17). Denies the material allegations of fact contained in paragraphs (16) and (17) of the petition.

(18) Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

16 Further answering the petition and by way of affirmative relief the respondent avers:

19. The respondent erred in that in determining the deficiency asserted in the notice of deficiency he included as earnings of decedent to the date of his death in the partnership of McDermott, Enright & Carpenter, the sum of $42,911.32, whereas he should have included therein an amount of not less than $46,293.75.

20. In support of the foregoing assignment of error, the respondent alleges the following facts:

The sum of $42,911.32, included in net taxable income as shown in the notice of deficiency on account of decedent's share of earnings of the partnership of McDermott, Enright & Carpenter represented an estimate shortly after the date of decedent's death. The actual collections made to date on account of said share of such earnings of decedent to date of his death equal the aggregate sum of $46,293.75. This sum should be included in taxable income instead of $42,911.32.

Wherefore, it is prayed that the appeal be denied, and that the tax liability of the petitioner be redetermined in that the respondent's affirmative issue as set forth in paragraphs 19 and 20 hereof, be sustained by the Board and the deficiency be redetermined accordingly. Claim is hereby asserted for the increased deficiency resulting from the decision of respondent's affirmative issue in his favor.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
E. O. HANSON,
Division Counsel,
J. RICHARD RIGGLES, Jr.,
Special Attorney, Bureau of Internal Revenue.

17 Before United States Board of Tax Appeals

Reply to amended answer

Filed May 6, 1939

The petitioners, Estate of John M. Enright, deceased, James C. Enright, Emma E. Neilson, and Mildred L. Enright, executors, by their attorney, James D. Carpenter, Jr., for their reply to the amended answer filed in the above-entitled appeal, aver as follows:

(1) to (18), inclusive. They join issue with respect to the matters alleged in paragraphs (1) to (18), inclusive, of the amended answer.

(19) They admit the allegation in paragraph (19) of the amended answer that the respondent included as earnings of decedent to the date of his death in the partnership of McDermott, Enright & Carpenter, the sum of $42,911.32, in determining the deficiency asserted in the notice of deficiency. They deny that the respondent should have included as earnings of the decedent to the date of his death in the partnership of McDermott, Enright & Carpenter an amount of not less than $46,293.75, or any part of such amount.

(20) They deny that the sum of $46,293.75 or any part thereof should be included in taxable income of the decedent. They admit all other material allegations of fact contained in paragraph (20) of the amended answer.

Respectfully submitted.

JAMES D. CARPENTER, Jr.,
Counsel for Petitioners,
75 Montgomery Street, Jersey City, New Jersey.

18 Before United States Board of Tax Appeals

Memorandum opinion

Rendered August 28, 1939

Docket Nos. 93754, 93755, 93756, 93757, 93758, 93813, and 97797

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

JAMES D. CARPENTER, JR., AND MRS. EMILY A. CARPENTER, HIS WIFE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

HOWARD C. GILMOUR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

PATRICK A. DWYER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

19 CARL S. KUEBLER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

JAMES D. CARPENTER, JR., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

James D. Carpenter, Jr., Esq., and Elmer J. Bennett, Esq., for the petitioners.

J. Richard Riggles, Jr., Esq., for the respondent.

MURDOCK. The Commissioner determined deficiencies in income tax as follows:

Docket No.	Taxpayer	Year	Amount
93754	Estate of John M. Enright	1934	$16,250.52
93755	James D. Carpenter, Jr. and Emily A. Carpenter	1934	276.24
		1935	3,163.89
93756	Howard C. Gilmour	1934	75.58
		1935	651.55
		1936	159.29
93757	Patrick J. Dwyer	1934	44.88
		1935	343.47
		1936	91.19
93758	Carl J. Kuebler	1934	19.84
		1935	354.39
		1936	98.61
93813	James D. Carpenter, Jr.	1936	827.79
97797	Estate of John M. Enright	1935	4,943.82

The Commissioner, in determining the deficiency for 1934 against the Estate of John M. Enright, included in income, under section 42 of the Revenue Act of 1934, $42,911.32, representing the deceased's share at the date of his death in income of a law partnership earned to that date but not collected. That action of the Commissioner is assigned as error by the petitioner in docket number 93754. The Commissioner, by amended answer, claims that the correct amount is not less than $46,293.75, the actual amount collected and distributed to the estate to the date of the hearing.

The Commissioner, as a precaution in case he was in error as to the estate of Enright, included in the income of the continuing partners, amounts collected and paid to the estate. He also included in the income of the estate for 1935 the amount received by the estate from the partnership in that year. He concedes that he erred in all of these cases if he was right in the first case mentioned.

The facts stipulated are found as stipulated.

John M. Enright died on November 19, 1934. He had been a partner in a law firm in Jersey City, New Jersey, up to the time of his death. The firm was upon a calendar year cash receipts basis. The partners were all upon a cash basis. The net income was distributable as follows:

John M. Enright	34½%
James D. Carpenter, Jr	34½%
Howard S. Gilmour	13%
Carl S. Kuebler	9%
Patrick A. Dwyer	9%

The partnership agreement provided that in case Enright died his interest would consist of his interest upon the above percentage basis in cash, accounts receivable and "the
21 earned proportion of the estimated receipts from unfinished business." The decedent by his will directed his executors to accept Carpenter's valuation of partnership items. The surviving partners formed a new partnership immediately after Enright died and continued the business. The new agreement provided that Carpenter was to estimate the earned portion of receipts from unfinished business for the purpose of paying the Enright estate.

Enright's interest in partnership cash at the date of his death was $4,143.81 and his interest in collectible accounts receivable at that time was $2,055.55. The partnership at that time was handling over 400 pending cases in which work had been done and on which additional work had to be done before the amount of fees to be charged could be determined and billed to clients. Carpenter estimated that the firm had earned by work upon those cases up to November 19, 1934, about $118,522.51 and that Enright's interest therein was $40,855.77. The $2,055.50 item and the $40,855.77 item or $42,911.32 were reported as a part of Enright's estate for state and federal estate tax purposes.

The share of Enright in cases being handled upon the basis of a fixed fee was $1,024.89 but those fixed fees were payable after his death upon a monthly or yearly basis. Almost all other cases were being handled under understandings with clients that the fee would be a reasonable amount for work done, taking into account, results, time and effort, and the amount involved. Only a few cases were being handled upon a contingent-fee basis and such cases Carpenter valued in his estimate at one dollar.

As the new firm made collections on old business it paid Enright's share to his estate.

The executors filed a return for Enright for 1934 and included his share of the partnership cash, $4,143.81. The Commissioner, in determining the deficiency, added $42,911.32, representing his share of accounts receivable and his share of estimated earnings to the date of his death.

22 The new firm, up to the date of the hearing, had collected $46,293.75 upon Enright's share of old business and had paid $45,965.15 to the estate.

The following facts are found from testimony of Carpenter:

The amount estimated as Enright's share of earned fees on unfinished business would not have been realized in full had the new firm not completed the business.

Enright was on a cash basis and did not receive any of the $42,911.32 in controversy. The question is whether it was prop-

erly included in his income under section 42 of the Revenue Act of 1934 which contains a special provision on the subject of income earned up to the death of a decedent. The provision is as follows:

"In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death * * *."

The purpose of the provision was to tax that income, earned but not received, which would otherwise escape taxation. It would not be taxable to the deceased, because never received by him; and it would not be taxable to his estate, because it would be capital to it. See discussion in Lillian O. Fehrman, Executrix, 38 B. T. A. 37. The effect of the provision was to require that the deceased be placed upon an accrual basis at the date of his death. The Commissioner has followed the statute in the case of Enright and has determined that $42,911.32 was an accruable item at that date.

The share of accounts receivable and the share in the fixed fee items were certainly accruable. The evidence does not show the situation in regard to the other items making up the $40,855.77 in sufficient detail to enable the Board to determine whether or not they were accruable. Some of them may have been sufficiently definite to permit an accrual, while others
23 may have been too indefinitet or contingent. We must decide the case upon the record before us. That record does not show that any of the estimated fees were too indefinite for accrual of the amount fixed by Carpenter and consequently we are unable to say that less than $42,911.32 was income under section 42. Cf. Gussie K. Barth, 35 B. T. A. 546. On the other hand, the evidence does not show that any greater amount was accruable on November 19, 1934. We are forced to leave the parties as we found them. The determination of the Commissioner in docket number 93754 is sustained and, in view of the concession of the respondent, the other issues need no consideration.

Decision will be entered under Rule 50.

Before United States Board of Tax Appeals

Decision

Entered November 21, 1939

It appears from the opinion in this case that no recomputation under Rule 50 was necessary since the determination of the

Commissioner was sustained. In view of this fact and after due consideration, it is

Ordered and decided, that at this docket number there is a deficiency of $16,250.52 for the calendar year 1934.

(Sgd.) J. E. MURDOCK,
Member, United States Board of Tax Appeals.

24 In United States Circuit Court of Appeals for the Third Circuit

B. T. A. No. 92754

Petition for review and assignments of error

Filed November 25, 1939

To the Honorable Judges of the United States Circuit Court of Appeals, for the Third Circuit:

Now come James G. Enright, Emma E. Neilson, and Mildred L. Enright, Executors of the Estate of John M. Enright, deceased, and respectfully show and charge as follows:

I. JURISDICTION

That the petitioners on review are James G. Enright, Emma E. Neilson, and Mildred L. Enright, Executors of the Estate of John M. Enright, deceased.

That the respondent on review is the Commissioner of Internal Revenue.

The petitioners filed a United States income tax return for John M. Enright, deceased, for the year ending December 31, 1934, and paid income taxes shown to be due thereon aggregating $6,287.36.

This is a proceeding for review by the United States Circuit Court of Appeals for the Third Circuit of the deter-
25 mination of the United States Board of Tax Appeals of August 18, 1939, and judgment thereon, which held that your petitioners were liable for a deficiency in income tax for the year aforesaid of $16,250.52, under Section 42 of the Revenue Act of 1934.

The tax return of your petitioners was filed in the office of the Collector of Internal Revenue at Newark, New Jersey, and the taxes were paid to such collector.

Jurisdiction is given to this Honorable Court in this case by United States Code, Title 26, Section 641.

II. NATURE OF THE CONTROVERSY

John M. Enright died November 19, 1934, a resident of Freehold, Monmouth County, New Jersey. He was senior member of the law firm of McDermott, Enright & Carpenter, which was engaged in the practice of law at 75 Montgomery Street, Jersey City, New Jersey. The partnership at the date of his death consisted of John M. Enright, James D. Carpenter, Jr., Howard C. Gilmour, Carl S. Kuebler and Patrick A. Dwyer.

The partnership agreement effective at the date of death provided that "the earnings of the firm distributable to the partners shall be determined annually on the basis of cash receipts and disbursements." The share of John M. Enright was 34½ percent. In the event of retirement of any member, by death or otherwise, it provided "that the interest of such retiring member shall consist of his interest on the above percentage basis in the net moneys then in the treasury of the firm, plus his like percentage in the outstanding accounts and the earned proportion of the estimated receipts from unfinished business." Said determination was to be made by joint agreement of the retiring member or his personal representative and the remaining senior partner as of the effective date of retirement.

The last will and testament of John M. Enright contained a provision directing his executors to accept the valuation of various items of business in the hands of the firm as fixed by his partner, James D. Carpenter, Jr.

26 Immediately upon the death of said John M. Enright, his surviving partners formed a new partnership, practicing law in the same offices under the firm name of McDermott, Enright & Carpenter.

The interest of John M. Enright at the date of his death in the cash on hand in the firm bank account was $4,143.81. This amount was included in the income tax return filed by the executors of the Estate of John M. Enright for the calendar year 1934 as income accrued to the date of death and the tax was paid thereon.

At the date of the death of John M. Enright, the other assets of the firm consisted of the following:

1. Accounts receivable, considered collectible, $5,948.12. The interest of John M. Enright therein at 34½ percent was $2,055.55.

2. Over 400 pending cases in which additional work had to be done before the amount of fees to be charged could be determined and the cases billed to the clients.

In order to determine for purposes of the Federal estate tax and the New Jersey transfer inheritance tax the probable value of the interest of the decedent in the partnership of McDermott,

Enright & Carpenter, an appraisal of all the aforesaid cases was made by James D. Carpenter, Jr., the surviving senior partner, and it was determined that the probable amount that had been earned in all pending cases by the firm to the date of the death of John M. Enright, including the probable realizable cash disbursements, aggregated $118,422.51, and that the interest of John M. Enright at his said 34½ percent was $40,855.77. This sum, together with the interest in the accounts receivable of $2,055.55, amounted to $42,911.32, which sum was reported in the Federal estate tax return and in the New Jersey transfer inheritance tax return as John M. Enright's interest in the business of the firm at the date of his death and taxes were assessed and paid on said amount.

27 Subsequent to November 19, 1934, the date of Mr. Enright's death, the interest of John M. Enright in the fees and disbursements collected on business of the old firm, earned to the date of his death, were collected as follows:

November 19, 1934, to December 31, 1934	$5,497.15
1935	24,942.52
1936	6,793.39
1937	5,578.51
1938	3,153.58
Total	45,965.15

These amounts were paid during the aforesaid years or paid in part during said years and in part during the early part of the following year by the successor firm of McDermott, Enright & Carpenter after it received the fees on the conclusion of the various cases. The amount paid the Enright Estate represented its 34½ percent interest in the respective fees. In fifty-five cases the fees actually collected by the successor firm were in excess of the appraised value and in twenty-two cases the fees were less than those estimated. The interest of decedent, to wit, 34½ percent, was paid on the amounts collected after they were received by the successor firm. No payments were made in advance of collection and the amount of the original appraisal was used solely for the purposes of determining the Federal estate tax and the New Jersey transfer inheritance taxes on decedent's net estate. It was stipulated at the time of the hearing before the Board of Tax Appeals that a total of $40,293.75 had been paid to the date of trial.

The aforesaid sum of $45,965.15 paid to the Estate of John M. Enright during the years 1934, 1935, 1936, 1937, and 1938 was not included in the income tax return filed by the Estate of John M. Enright for 1934 or any of said subsequent years. The income tax return for the firm of McDermott, Enright & Carpenter for such years showed the amounts paid to the

28 Estate of John M. Enright as payments in liquidation of the interest of John M. Enright in the old firm of McDermott, Enright & Carpenter.

In 1935, 1936, 1937, and 1938 the Estate of John M. Enright filed information returns and the individual executors, the beneficiaries of John M. Enright in equal shares (with certain exceptions as to Mildred L. Enright), have not reported the moneys received from McDermott, Enright & Carpenter in liquidation of the interest of Mr. Enright in the firm, as income.

On March 5, 1938, the Commissioner of Internal Revenue advised decedent's executors of a deficiency of $16,250.52 of income tax for the taxable year ending December 31, 1934. The statement annexed to said advice showed that the Commissioner increased the decedent's income for the calendar year 1934 as follows:

"Explanation of Adjustments

* * * * *

"(b) The indicated amount, $42,911.32 has been included in the gross income of the decedent as income accrued up to the date of his death, under the provisions of Section 42 of the Revenue Act of 1934, the said amount representing the decedent's share of fees earned or partially earned by the old firm of McDermott, Enright & Carpenter up to the date of his death, as determined by Mr. James D. Carpenter, the surviving senior member of the firm."

The amount of $42,911.32 was the esitmated amount of decedent's interest in the firm as appraised for the purposes of Federal estate tax and New Jersey transfer inheritance tax.

Your petitioners promptly and within the time allowed by law filed with the United States Board of Tax Appeals a petition praying that the said deficiency tax liability be redetermined, set aside and vacated.

On the trial before the Board of Tax Appeals, most of the facts aforesaid were stipulated and the testimony of James D. Carpenter, Jr., was introduced.

29 In due time, after the submission of briefs by counsel for the respective parties, the Board of Tax Appeals on August 28, 1939, filed its opinion and determination, affirming the determination of the Commissioner of Internal Revenue.

This appeal is taken from said portion of the determination of the United States Board of Tax Appeals aforesaid dated August 28, 1939, which affirms the Commissioner of Internal Revenue in his determination made in this cause on Docket No. 93754.

No appeals are taken from decision in the cases bearing the Docket Nos. 93755, 93756, 93757, 93758, 93813, and 97797 referred to in the said decision, which cases were consolidated and tried with this case Docket No. 93754.

III. ASSIGNMENTS OF ERROR

Petitioners allege that the United States Board of Tax Appeals erred in the following respects:

(1) In holding that the sum of $42,911.32, being the amount estimated as decedent's interest in the uncollected outstanding accounts and pending cases in the partnership of McDermott, Enright & Carpenter, for the purpose of fixing the value of decedent's gross estate for Federal estate tax and New Jersey transfer inheritance tax purposes, was taxable income within the meaning of Section 42 of the Revenue Act of 1934.

(2) Because the Board found that the effect of Section 42 of the Revenue Act of 1934 was to require that decedent be placed upon an accrual basis at the date of death, whereas the said Board found as a fact that decedent was on a cash basis prior to the time of death and did not receive in his lifetime any of said sum of $42,911.32 in controversy in this appeal.

(3) Because said Board erroneously determined that the sum of $42,911.32 was income accrued at the date of death of John M. Enright, although it found as a fact that the amount estimated as decedent's share of the fees of McDermott, Enright & Carpenter on unfinished buisness at the time of his death, to wit, $40,855.77 thereof, would not have been realized had a new firm not been organized and completed the business.

(4) Because the Board did not hold as a matter of law that no income accrued to John M. Enright from his partnership of McDermott, Enright & Carpenter on outstanding accounts of said firm or pending business until said accounts and fees were in fact paid by clients of the partnership.

(5) Because said Board did not hold that decedent had no income accrue to him from the partnership of McDermott, Enright & Carpenter on the unfinished law business in the hands of the partnership until such business was concluded, the amount of fee determined either by Court order, in the case of business handled for the courts, or by agreement with clients in the case of business handled for clients, and until the money was collected by the partnership, both the partnership and decedent being on the cash basis.

(6) Because Section 42 of the Revenue Act of 1934, under which the tax in controversy was levied, is null and void in that

it is not a tax on income within the meaning of the Sixteenth Amendment and was not laid in proportion to the census within the meaning of Article I, Section IX, paragraph 4 of the Constitution of the United States.

(7) Section 42 of the Revenue Act of 1934, as construed by the Board of Tax Appeals, is in conflict with the Fifth Amendment to the Constitution of the United States and is null and void for the reasons:

(a) That said section attempts to define as income, taxable at the date of said taxpayer's death, the estimated present money value of services performed by a partnership, of which de-
31 ceased was a member, when in fact the reasonable value of the services of the partnership are not in fact income and do not become such even to the partnership until the completion of the services by the succeeding partnership over a period of years in the future;

(b) said section attempts to tax to a deceased partner his share of such estimated present money value as income accrued to the date of his death, yet income taxes as to all other members of the partnership are assessed as of the date when the partnership receives and distributes the proceeds of services rendered; and

(c) said section is arbitrary, harsh, and confiscatory in that, where members of a partnership are all on a cash basis and one dies it makes the fact of death create the interest in the partnership of the deceased partner as taxable income, although the interest of the surviving partner or partners is not taxable income until the partnership assets are liquidated.

(8) Section 42 of the Revenue Act of 1934, as construed and applied by the Board of Tax Appeals, violates the Fifth Amendment to the Constitution of the United States and is null and void in that it attempts to create income and impose a tax thereon upon what is in fact corpus.

(9) The Board of Tax Appeals erred in affirming an income tax assessed upon the reasonable value of work done rather than upon income either received or accrued.

(10) The tax under review is null and void in that it is an attempted levy of an income tax upon the reasonable value of work done by a law partnership rather than on income received by or accrued to a deceased member of said partnership.

(11) Section 42 of the Revenue Act of 1934 is null and void as violative of the Fifth and Sixteenth Amendments to the Constitution of the United States in that the tax imposed by
32 said section falls solely because of the death of the taxpayer, which event under the statute arbitrarily transfers the taxpayer from a cash basis, under which he had been oper-

ating in his lifetime, to an accrual basis, in order to create income and tax that which was in fact not income prior to death, and upon death in fact became corpus.

Wherefore your petitioners pray that the judgment and determination of the United States Board of Tax Appeals may be reviewed by the United States Circuit Court of Appeals for the Third Circuit; that a transcript of the record be prepared in accordance with the law and rules of said court and transmitted to the clerk of said court for filing, and that the determination of the Commissioner of Internal Revenue and United States Board of Tax Appeals aforesaid may be reversed and set aside for the reasons aforementioned.

JAMES D. CARPENTER, JR.,
Attorney for and of Counsel with Petitioners.

Dated November 24, 1939.

33 [*Duly sworn to by James G. Enright et al.; jurat omitted in printing.*]

34 Before United States Board of Tax Appeals

Statement of evidence; stipulation of facts; agreement as to Statement of Evidence

Filed January 20, 1940

At the hearing before the Board held at the United States Court House, New York, on May 3, 1939, before Hon. J. E. Murdock, Member of the United States Board of Tax Appeals.

The appearances were as follows: James D. Carpenter, Jr., and Elmer J. Bennett, 75 Montgomery Street, Jersey City, N. J., appearing on behalf of petitioners; J. Richard Riggles, Jr. (Hon. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, respondent.

The stipulation of facts as agreed upon by counsel for the respective parties was presented to the Member.

JAMES D. CARPENTER, Jr., a witness on behalf of the petitioners, testified as follows:

I went with the firm of McDermott & Enright in the capacity of managing clerk in 1909, and became a partner in 1912, and was a partner of Mr. Enright until he died, November 19, 1934, excepting during the time that he was in Washington as a member of the War Trade Board during the war.

I started to appraise all the matters in the office belonging to John M. Enright in his capacity as a partner, the day that he died, but I did not finish it until nearly a year later. This appraisal was made for the purposes of Federal estate tax and the State of New Jersey transfer inheritance tax on his estate. We had to do this in order to know what his gross estate was on which to pay such taxes.

35 Shortly after Mr. Enright's executors qualified, I had a conversation with them and we made a survey of what his assets were. I discussed with them the provisions of his will regarding the liquidation of the partnership and asked them how they preferred to have the liquidation carried out. I told them how we had liquidated the interest of another member in 1921, and we agreed that the interest of John M. Enright in the firm should be liquidated case by case, and the amount of his interest should be paid to them from time to time at the convenience of the successor firm, and that is what we have done.

I know from my knowledge of the business in the office and how it was handled and what has happened that had we not continued the business with considerable success and good fortune, we would not have realized the amount we have ultimately realized, nor could we have realized the amount I estimated. Some of the firm business was the representation of receivers and trustees executors, and administrators, and allowances in our State in such matters are subject to the approval of the courts, in fact, they are made by the courts. I am perfectly confident in those cases had the successor firm not been formed to carry on the business and had we sent out bills or applied for allowances to date, we never could have realized and the court would not have ordered any such per diem rate as we ultimately received, and I am confident that hard work and perhaps some good fortune increased the amount anticipated. In many cases it indicates that we received a per diem rate over what I had originally estimated.

Mr. Enright and all his partners were in 1934 and always have been on a cash basis and none of them has ever been on an accrual basis. So is the firm.

CROSS-EXAMINATION

The firm of McDermott, Enright & Carpenter has two loose-leaf ledgers, a cash book, and check book. These records do not show any capital accounts or capital interest

36 for the individual partners. No goodwill is shown on the books. The only intangibles of any nature are accounts receivable. The firm had no money nor any investments in stocks

or bonds. It had cash in bank, accounts receivable, and the decedent's interest in unfinished business in the office as of the date of decedent's death. It was only on the accounts receivable and his interest in the unifinished cases in the office on which I estimated the value of Mr. Enright's interest for the purposes of the estate taxes. There was no invested capital in the estimated amount of $42,000, in the sense that you mean money put out at interest, but I consider that the investment of a man's time and services is capital, a capital element down to the date of his death. The business which for the purposes of Federal estate and state transfer inheritance taxes I considered as worth $42,000, includes only decedent's interest in the business which was in the office at the date of death and does not include any cases that came into the firm subsequent to his death. The cases that were in the office at the date of Mr. Enright's death had been in the office for a longer or shorter period. Some work had been done on all the cases and I took them case by case as to the amount of work that had been done upon them and the time that had been spent upon them. There were approximately four hundred matters in the office, and there were all sorts of arrangements as to how they were being handled. Some of them were on appointment by the court where we were appointed to represent receivers, trustees, and whatnot. In some cases, administrators, and in those matters the fees were fixed by order of the court after the work had been done. There were a few cases where we were working on retainers payable by the month or by the year, none being payable at the time of death. There were others that we were handling on a per diem basis. There were others where we would be paid a reasonable fee for the work done, taking into consideration and into account the time devoted to the case,
37 the amount involved and the success. A few were being handled on a contingent fee basis. There were a number that I appraised at a dollar, because I would not have given more than a dollar for them. The number of strictly contingent cases I figured as only four or five. They were very few. Our experience in them was not good and I do not approve of handling cases on a contingent fee basis. All other cases in the office were being handled on the quantum meruit basis. Except those where we were appointed by the court—trustees and whatnot, practically everything was on the quantum meruit basis, being paid a reasonable fee for services rendered, depending upon the time devoted to the case, the amount involved in the case and the result obtained. Practically everything in the office was on that basis.

I completed the appraisal in November 1935. I tried to make it just as accurate as I could, because I did not want to make a mistake about it and I wanted to be able to have something

which would be correct and accurate for checking by the transfer inheritance and Federal estate tax authorities, and I took nearly a year from the time of Mr. Enright's death to complete that appraisal, trying to get the benefit of all the closed cases, which made it more accurate, my idea being accuracy. During that time we made collections in some of the cases and gained by that experience, and each closed case aided me in determining the appraisal value of $42,000, to the extent that the money was in hand and I could tell what the case was worth. As to everything else in the office that was unfinished, I could do no more than make an approximation or a guess even by the first of November 1935, if by that time. If by the first of November 1935, we closed a case and the fee was paid, then I could tell exactly how much it worked out per diem and calculate the days to Mr. Enright's death and the days subsequent and be very accurate, but I could not tell, necessarily, on the date of his death as to cases not closed.

38 The appraisal was $42,911.32. The collections subsequent have shown a larger amount, spreading over the period to the first of this year, 1939. The amount collected as Mr. Enright's share to date is $45,965.15, and we are not done yet. There are other cases that have not been completed, totalling thirty or forty. The outstandings unpaid are small. I can not give you much of an approximation of it at this time, which is four and one-half years after Mr. Enright's death. I am still hopeful that I will wind up advantageously one or two matters, but that is not much more than a hope. If I depend on the amount estimated at the date of death, the amount appraised on those few extra cases is small.

Stipulation of facts

It is hereby agreed between counsel for all the above-named petitioners and counsel for the respondent as follows:

1. That all of the above cases shall be tried together and that the facts as herein stipulated shall be admitted in all of said cases, provided however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true.

2. John M. Enright, a resident of Freehold, Monmouth County, New Jersey, died testate November 19, 1934.

He was senior member of the law firm of McDermott, Enright & Carpenter, which was engaged in the practice of law at 75 Montgomery Street, Jersey City, New Jersey.

The partnership at the date of his death consisted of John M. Enright, James D. Carpenter, Jr., Howard C. Gilmour, Carl S. Kuebler, and Patrick A. Dwyer.

3. The partnership agreement which was in effect at the date of the death of John M. Enright was dated January 14, 1928, and contained the following provisions which are material in this controversy:

39 "(2) The earnings of the firm distributable to the partners shall be determined annually on the basis of cash receipts and disbursements.

"All receipts subsequent to the date hereof shall be considered as income subject to this agreement, regardless of when earned, and all liabilities of McDermott, Enright & Carpenter paid subsequent to the date hereof shall be considered as expenses of the firm and shall be deducted from the receipts, regardless of when such liabilities were contracted.

* * * * *

"(4) The net income of the firm shall be distributed as follows:

John M. Enright	34½%
James D. Carpenter, Jr.	34½%
Howard C. Gilmour	13%
Carl S. Kuebler	9%
Patrick A. Dwyer	9%"

(as amended by supplemental contract dated January 2, 1934.)

* * * * *

"(5) In the event of the retirement through death or otherwise of the present members of the firm, Messrs. Enright and Carpenter, or either of them, it is agreed that the interest of such retiring member shall consist of his interest on the above percentage basis in the net monies then in the treasury of the firm, plus his like percentage in the outstanding accounts and the earned proportion of the estimated receipts from unfinished business. The value of such outstanding accounts and unfinished business shall be determined if possible as of the effective date of such retirement, by the joint agreement of such retiring member or his personal representative, and the senior remaining partner. * * *

40 "The amount so determined shall be paid by the remaining members who elect to carry on the firm, in equal monthly instalments, within eighteen months from the date of such retirement.

"(6) In all events the books of account and office records of the firm shall be and remain the property of the surviving members carrying on the firm, and in no event shall any member or

the personal representative of any deceased member of the firm be entitled to any judicial accounting of the affairs of the firm."

4. The last will and testament of John M. Enright, probated at Freehold, New Jersey, contained the following provision:

"Eighth: In settling my interest in the law firm of McDermott, Enright & Carpenter, I direct my executors to accept the valuation of the various items of business in the hands of the firm as fixed by my partner James D. Carpenter, Jr., and to accept payment for my interest therein upon such terms of credit as my said partner may deem reasonably necessary for the liquidation thereof out of the business."

5. Immediately after the death of the said John M. Enright his surviving partners formed a new partnership, practicing law in the same offices as the preceding firm, under the firm name of McDermott, Enright & Carpenter.

Paragraph 2 of the new partnership agreement provides as follows:

"Pursuant to the provisions of the Will of John M Enright, who died this day, and the provisions of paragrapn 5 of the firm agreement of January 14, 1928, the earned proportion of the estimated receipts from unfinished business of the former firm
41 shall be determined by the said James D. Carpenter, Jr., whose decision thereon shall be binding and conclusive upon the parties hereto.

"It is mutually agreed that the amount so determined by the said Carpenter shall be paid to the estate of John M. Enright as soon as practicable out of all receipts of the firm, whether in liquidation of business of the former firm or from new business of this firm. So much of the net earnings of this firm from and after the date hereof as equals thirty-four and one-half percent (34½%), (being the interest of John M. Enright as of the date of his death), shall be considered as earned in liquidation of the business of the old firm and so paid, whether or not received from liquidation of business of the old firm. (It is the purpose of this provision to avoid the trouble and expense of running two sets of books, one, the liquidation of the old firm and its business, and the second, a new set of books for this firm allocating strictly the monies received in each firm, and likewise to avoid charging against the interest of John M. Enright expense for overhead and other costs of liquidating his interest in the old firm, which would entail the employment of a bookkeeper or accountant, the opening of separate bank accounts, etc.)

* * * * * *

"The net income of the firm shall be distributed as follows:

"James D. Carpenter, Jr., fifty-one percent (51%);

"Howard C. Gilmour, twenty percent (20%);
"Carl S. Kuebler, fourteen percent (14%);
"Patrick A. Dwyer, fifteen percent (15%).

* * * * *

"The amount distributable to all partners during the continuance of this agreement, as well as the amount distributable to Messrs. Gilmour, Kuebler, and Dwyer, or any of them, in the event of their respective retirement from the firm, shall be
42 determined from time to time by James D. Carpenter, Jr., and the amount so determined by him shall be final and conclusive upon all parties hereto."

6. The interest of John M. Enright at the date of his death in the cash on hand in the firm bank accounts was $4,143.81.

In the income tax return filed by the executors of John M. Enright for the calendar year 1934, said sum of $4,143.81 was included as income accrued to the date of death and the tax was paid thereon, although said sum was not actually distributed by the successor firm to the executors until February 26, 1935.

7. The other assets of the firm at the date of the death of Mr. Enright consisted of the following:

(1) Accounts receivable considered collectible $5,948.12, the interest of John M. Enright therein at 34½ percent, being $2,055.55.

(2) Over 400 pending cases in which work had been done and on which additional work had to be done before the amount of fees to be charged could be determined and the cases billed to clients.

8. James D. Carpenter, Jr., the surviving senior partner of the former firm of McDermott, Enright & Carpenter, appraised all of the cases in the office at the date of Mr. Enright's death and determined that the probable amount that had been earned by the firm to the date of the death of John M. Enright, including the probable realizable cash disbursements, aggregated $118,422.51, and that the interest of John M. Enright in said estimated value, at 34½ percent thereof, was $40,855.77.

The aggregate of Mr. Enright's interest in the accounts receivable of $2,055.55, plus the estimated amount of his interest in the unfinished cases in the firm of $40,855.77, was $42,911.32,
43 which sum was reported in the Federal Estate Tax Return and in the New Jersey Transfer Inheritance Tax Return as John M. Enright's interest in the business of the firm to the date of his death.

9. The firm had nine matters pending in the office as of the date of Mr. Enright's death in which work was being done on a fixed fee basis, and Mr. Enright's share of the amounts earned in

said matters to the date of his death was $1,024.89 (which amount is included in said sum of $42,911.32). In none of these matters, however, were the fees payable at the date of death but they were payable on a per month or per annum basis at future dates.

Practically all other pending matters in the office of the firm were being handled on the basis of the firm being paid a reasonable fee for the work done, taking into account the amounts involved, the results accomplished for the clients, and the time and effort devoted to the cases. A few cases were being handled for clients on a contingent fee basis in which the amount of fee ultimately realizable depended solely upon success.

The amounts payable to the firm upon the completion of the business also depended upon the client being satisfied with the amount of fee charged.

In determining that the value of the pending unfinished business of the firm was $118,422.51, all contingent cases in the office were valued at one dollar each.

10. The executors of the estate of John M. Enright are his brother and two sisters.

It was agreed between the executors and James D. Carpenter, Jr., that the estimate of decedent's interest in the firm accounts of $42,911.32 was to be used for the purposes of Federal estate and New Jersey transfer inheritance tax returns and that the amount ultimately realizable for the estate as Mr. Enright's earned proportion at date of death in the unfinished business of the firm might ultimately be either greater or less than said estimate.

44 11. The firm of McDermott, Enright & Carpenter, John M. Enright, the Estate of John M. Enright, and all of the individual partners in the firm of McDermott, Enright & Carpenter filed their income tax returns on the cash basis for the taxable years under consideration.

12. Between November 19, 1934 (the date of Mr. Enright's death), and December 31, 1934, the interest of John M. Enright in the fees and disbursements collected on business of the old firm earned to the date of Enright's death amounted to $5,497.15. This amount was paid his executors March 25, 1935.

During the calendar year 1935 the firm of McDermott, Enright & Carpenter collected fees in 208 cases that were in the office at the date of death of John M. Enright and 34½ percent of the portion of such fees earned to the date of Mr. Enright's death (plus his share of the disbursements made by the firm to the date of his death), aggregated $24,942.52. Said sum of $24,942.52 was paid to his executors as follows:

March 25, 1935	$2,698.24
November 18, 1935	10,000.00
February 11, 1936	10,000.00
August 28, 1936	2,244.28
	$24,942.52

In the year 1936 the firm of McDermott, Enright & Carpenter collected fees in ninety-seven cases that were in the office at the date of death of John M. Enright and 34½ percent of the portion of such fees earned to the date of Mr. Enright's death (plus his share of the disbursements made by the firm to the date of his death) aggregated $6,793.39. Said sum of $6,793.39 was paid to his executors as follows:

November 9, 1936	$5,972.84
February 3, 1937	820.55
	$6,793.39

45 In the year 1937 the firm of McDermott, Enright & Carpenter collected fees in twenty-eight cases that were in the office at the date of death of John M. Enright and 34½ percent of the portion of such fees earned to the date of Mr. Enright's death (plus his share of the disbursements made by the firm to the date of his death) aggregated $5,578.51. Said sum of $5,578.51 was paid to his executors as follows:

July 7, 1937	$4,905.54
May 24, 1938	672.97
	$5,578.51

In the year 1938 the firm of McDermott, Enright & Carpenter collected fees in twenty-seven cases that were in the office at the date of death of John M. Enright and 34½ percent of the portion of such fees earned to the date of Mr. Enright's death (plus his share of the disbursements made by the firm to the date of his death) aggregated $3,153.58. Said sum of $3,153.58 was paid to his executors as follows:

May 24, 1938	$2,068.53
December 6, 1938	998.75
February 2, 1939	86.30
	$3,153.58

The total amount paid to the estate of John M. Enright, deceased, in liquidation of his earned proportion of the receipts from business that was in the office at date of death, aggregates $45,965.15 to date.

13. In the partnership returns of income (Form 1065), filed by McDermott, Enright & Carpenter, Mr. Enright's distributive share of net income is reported is Schedules B as follows:

46

1934

John M. Enright, Freehold, N. J., died November 19, 1934:		
34½% of net income of business transacted and paid to firm before November 19, 1934	$26,568.81	
34½% of net income of business transacted before November 19, 1934, and paid to firm after November 19, 1934, to and including December 31, 1934 (Capital to Estate in liquidation)	3,936.40	
		$30,505.21

1935

Estate of John M. Enright, Freehold, N. J., 34½% of net income of business transacted before November 19, 1934, and paid to firm during calendar year 1935; capital to Estate in liquidation	24,942.52

1936

Estate of John M. Enright, 34½% of receipts from business transacted before November 19, 1934 (date of death), and paid to firm during calendar year 1936: capital to Estate in liquidation	6,793.39

14. The estate of John M. Enright filed an income tax return for the calendar year 1935 and did not return the amount received from the firm of McDermott, Enright & Carpenter, as income.

47 In subsequent years the estate of John M. Enright has filed information returns and the individual executors (the beneficiaries of John M. Enright in equal shares, with certain exception as to Mildred L. Enright) have not reported the monies received from McDermott, Enright & Carpenter in liquidation of Mr. Enright's interest in the firm, as income.

15. As each case was closed and the fee paid, Mr. Carpenter has reexamined the charge sheets to determine whether the amount he originally determined as the interest of John M. Enright therein to the date of his death was correctly stated.

In fifty-five separate cases, the amount determined to be due to Mr. Enright at the date of his death was increased, whereas in twenty-two cases the amount estimated to be due to Mr. Enright to the date of his death was decreased.

Thirty-five cases that were in the office of McDermott, Enright & Carpenter at the date of Mr. Enright's death are still pending unfinished.

Bills receivable aggregating $2,166.70 have been determined as uncollectible. Some of these bills receivable were on the books of the firm prior to Mr. Enright's death and others have been rendered in cases closed since his death.

At the present time, bills rendered since November 19, 1934, considered collectible, total $100, in which Mr. Enright's interest is 34½ percent.

From January 1, 1939, to date, the firm of McDermott, Enright & Carpenter has collected fees in six cases that were in the office at the date of death of John M. Enright and 34½ percent of the portion of such fees earned to the date of Mr. Enright's death (plus his share of the disbursements made by the firm to the date of his death) aggregates $328.60. Said sum has not, however, to May 1, 1939, been paid over to the executors of his estate by the firm.

Between the date of Mr. Enright's death and December 31, 1938, monies were received by the firm of McDermott, Enright & Carpenter in nine matters that were not on the
48 books of the firm at the date of Mr. Enright's death, and in which the files had been placed in storage. One of these matters was the return of part of a contribution toward a public investigation; two were the payment of the firm's share of costs on old judgments, and six involved the return of balances of deposits that had been advanced by the firm years before to clerks and marshals. Mr. Enright's estate was paid 34½ percent of all such amounts.

16. The liquidation of the interest of John M. Enright in the firm of McDermott, Enright & Carpenter has resulted as follows:

Amount estimated for estate and transfer inheritance tax purposes as the value of his interest—	
in outstanding accounts receivable	$2,055.55
in value of work in process	40,855.77
	42,911.32
Amount actually paid estate:	
March 25, 1935	8,195.39
November 18, 1935	10,000.00
February 11, 1936	10,000.00
August 28, 1936	2,244.28
November 9, 1936	5,972.84
February 3, 1937	820.55
July 7, 1937	4,905.54
May 24, 1938	672.97
May 24, 1938	2,068.53
December 6, 1938	998.75
February 2, 1939	86.30
	45,965.15
Six cases closed and bills paid since January 1, 1939, in which the interest of Mr. Enright's estate at 34½ percent is	328.60
Thirty-five cases still pending unconcluded. Interest in good accounts receivable aggregating $100, 34½ percent	34.50

49 17. The successor firm of McDermott, Enright & Carpenter did not buy the decedent's interest in the former firm from the estate of John M. Enright but paid his estate, after it was received, his percentage (34½ percent) of outstanding accounts collected and his earned proportion of unfin-

ished business after the fees were collected by the firm, and paid decedent's executors from time to time exactly what Mr. Enright was entitled to on strict liquidation making no deductions from such amount. No payments were made out of any receipts from new business of the new firm.

ELMER J. BENNETT,
Counsel for All Petitioners.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Order approving statement of evidence

Approved and ordered filed this twentieth day of January, 1940.

(Sgd.) C. R. ARUNDELL,
Member.

50 Before United States Board of Tax Appeals

Agreement between counsel as to the statement of evidence, stipulation of facts and record on appeal

Filed January 20, 1940

Counsel for the respective parties do hereby agree on the foregoing statement of evidence.

We further agree that the foregoing copy of stipulation of facts is a true and correct copy of the stipulation heretofore made between counsel for the respective parties and filed with the Board.

We further agree that the Clerk of the Board of Tax Appeals shall certify to the Clerk of the United States Circuit Court of Appeals for the Third Circuit as the record on appeal in this matter the following:

(1) The docket entries of proceedings before the Board.
(2) Pleadings before the Board.
(3) Opinion and decision of the Board.
(4) Petition for review.
(5) The within statement of evidence and stipulation of facts.

JAMES D. CARPENTER, JR.,
Attorney for and of Counsel With Petitioners.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, of Counsel With Commissioner of Internal Revenue.

51 [Clerk's certificate to foregoing transcript omitted in printing.]

52 In United States Circuit Court of Appeals for the Third Circuit

October Term, 1939

No. 7320

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS, PETITIONERS

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Minute entry of hearing

And afterwards, to wit, the 19th day of March 1940, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable John Biggs, Jr., Honorable Albert B. Maris, and Honorable Charles Alvin Jones, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 17th day of June 1940, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

53 In United States Circuit Court of Appeals for the Third Circuit

No. 7320. October Term, 1939

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review From the United States Board of Tax Appeals

Opinion

Filed June 17, 1940

Before BIGGS, MARIS, and JONES, Circuit Judges

MARIS, Circuit Judge: This is a petition to review a decision of the Board of Tax Appeals. Section 42 of the Revenue Act

of 1934 provides, inter alia, that "In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period." The question now raised is whether, in the case of a deceased
54 taxpayer who was a member of a partnership which kept its accounts and made its returns on a cash basis, there must be included in the decedent's return his share in partnership income earned but not yet received by the partnership in cash or reported in its income tax return and not distributable to him under the partnership agreement.

John M. Enright, the petitioners' decedent, was a member of a partnership of lawyers which kept its accounts and made its tax returns on the cash receipts and disbursements basis. Their partnership agreement provided that the earnings of the firm distributable to the partners should be determined annually on the basis of cash receipts and disbursements. Enright also made his returns on the cash basis. When he died on November 19, 1934, his distributable interest in the partnership's cash on hand was $4,143.81, and this was reported in the income tax return filed for him for the year 1934 as income accrued to him from the partnership, in addition to the income actually received by him from the firm during that year. It appeared that his interest in the collectible accounts receivable of the firm was $2,055.55 and in fees earned in whole or in part but not yet billed to or received from clients was $40,855.77. This sum of $42,911.32 the Commissioner added to the decedent's taxable income under Section 42 as an amount accrued up to the date of his death. The Board of Tax Appeals upheld the Commissioner. We think it erred in so doing.

The Board said in its memorandum opinion that the effect of the provision of Section 42 of the Revenue Act which we have quoted above "was to require that the deceased be placed upon an accrual basis at the date of his death." We agree that this was its effect. It follows that the decedent's taxable income should have been computed in the same way it would have been had he been alive and regularly making his returns on the accrual basis.

We think the Board fell into error in failing to treat the partnership as a tax computing unit separate from its member,
55 Enright. That the Revenue Act requires that a partnership be so treated is clear from its provisions for the computing of partnership income and the filing of partnership

returns and has been recognized by the courts.[1] Thus a partnership may make its return for a taxable year different from that of its members,[2] and it may likewise make its returns upon an accounting basis different from that used by the individual partners.[3]

Section 182 of the Revenue Act provides that "There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year." This is in effect a direction that even though a partner is on the cash basis of accounting he must nevertheless use the accrual method in accounting for his income from the partnership. But the partnership income which accrues to him and for which he must account is only that shown to be distributable to him by the partnership return prepared pursuant to the partnership agreement, since it is only that distributable income which he has the right to receive. "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues." Spring City Co. v. Commissioner, 292 U. S. 182, 184.

In the present case under the partnership agreement as reflected in the partnership accounts and returns Enright had the right to receive only his proportionate share of the cash receipts of the firm. Of these only $4,143.81 remained distributable to him at his death. We think it is clear from what has been said that this sum represented the partnership income accrued
56 to him up to the date of his death within the meaning of Section 42 of the Revenue Act. In our opinion that section did not require the inclusion as "amounts accrued" of the uncollected accounts receivable and unbilled fees which under the partnership's agreement and its accounting method were not distributable to him. The only previous consideration of this question which we have found appears in an article entitled "Accruals to Date for Income Tax Purposes" by Charles C. Parlin appearing in 87 U. of Pa. Law Review, p. 295. After a full discussion of the problem the author reaches the same conclusion to which we have come.

The decision of the Board of Tax Appeals is reversed.

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[1] Guaranty Trust Co v. Commissioner, 303 U. S. 493; Johnson v. Commissioner, 86 F. 2d 732, cert. den. 301 U. S. 683; Archbald v. Commissioner, 27 B. T. A. 837, aff. 70 F. 2d 720, cert. den. 293 U. S. 594.

[2] Sec. 188, Revenue Act of 1934.

[3] Truman v. United States, 4 F. Supp. 447; Fritz Hill v. Commissioner, 22 B. T. A. 1079; W. J. Burns v. Commissioner, 12 B. T. A. 1209; Appeal of Percival H. Truman, 3 B. T. A. 386.

Dissenting opinion

BIGGS, Circuit Judge (Dissenting): I must dissent respectfully from the opinion expressed by the majority of the court for the following reasons.

Section 42 of the Revenue Act of 1934 is clear and explicit. It provides, among other things, that upon the death of a taxpayer there shall be included in computing net income for the taxable period in which falls his death, "amounts accrued up to the date of his death, if not otherwise properly includible in respect of such period or a prior period." The purpose of Congress in enacting the Statute also is plain.[4] It was to tax income accrued prior to the death of a decedent who was on a cash basis, such income frequently having been held by the courts to be received by the estate as capital.

The majority seems to me to interpose an entirely fictitious barrier to the operation of Section 42. They say that because Enright, alive, could not have received his proportionate part of the partnership income until distribution of it was made in accordance with the partnership agreement, the income here sought to be taxed cannot be treated as accrued up to the date
57 of his death, relying upon Section 182 of the Revenue Act. Enright is dead, however, and the question for our determination is whether the income here taxed "accrued up to the date of his death." An examination of the partnership agreements, particularly paragraph 5 of the supplemental contract entered into by the partners upon January 2, 1934, as well as the eighth item of Enright's will, the partnership agreement entered following Enright's death, and Revised Statutes of New Jersey 42:2–24, makes it clear that the sums taxed by the decision of the Board were intended by the interested parties to be treated as accrued up to the date of Enright's death. Assuming that Section 182 of the Revenue Act is entitled to the interpretation given to it in the majority opinion, none the less I cannot conclude that such an interpretation is pertinent to the issue at bar in the light of the agreements and course of conduct between Enright and his partners.

I conclude that the case at bar is governed by the decisions of the Supreme Court in Bull v. United States, 295 U. S. 243, 254, and in Guaranty Trust Company v. Commissioner, 303 U. S. 493. The decision of the Board of Tax Appeals should be affirmed.

A true Copy:

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[4] See H. Rep. No. 704, 73d Cong., 2d Sess., p. 24, and S. Rep. No. 558, 73d Cong., 2d Sess., p. 28.

58 In United States Circuit Court of Appeals
For the Third Circuit

No. 7320. October Term, 1939

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON AND MILDRED L. ENRIGHT, EXECUTORS, PETITIONERS

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed June 17, 1940

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby reversed.

Philadelphia, June 17, 1940.

ALBERT B. MARIS,
Circuit Judge.

[File endorsement omitted.]

59 [Clerk's Certificate to foregoing transcript omitted in printing.]

60 Supreme Court of the United States

Order allowing certiorari

Filed November 12, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 44785. U. S. Circuit Court of Appeals, Third Circuit. Term No. 436. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Estate of John M. Enright, Deceased, James G. Enright, Emma E. Neilson and Mildred L. Enright, Executors. Petition for a writ of certiorari and exhibit thereto. Filed September 14, 1940. Term No. 436 O. T. 1940.

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CHARLES ELMORE CROPLEY
CLERK

No. 436

In the Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON AND MILDRED L. ENRIGHT, EXECUTORS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON AND MILDRED L. ENRIGHT, EXECUTORS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on June 17, 1940.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 18) is a memorandum opinion and therefore not

officially reported. The opinion of the Circuit Court of Appeals is reported in 112 F. (2d) 919.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 17, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether his share of income earned, but not yet received, by a partnership should be included in the gross income of a partner for the taxable period ending with his death, where both the partnership and the deceased partner kept books on the cash basis.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 8–10.

STATEMENT

The relevant facts, as stipulated by the parties (R. 38–49) and as found by the Board of Tax Appeals (R. 20–22), may be summarized as follows:

John M. Enright, who died on November 19, 1934, was a partner in a law firm in Jersey City, New Jersey, up to the time of his death (R. 20, 38). All the partners were upon a cash basis (R. 20, 44). The net income of the firm, which was upon a cal-

endar year cash receipts basis, was distributable as follows (R. 20, 39):

	Percent
John M. Enright	34½
James D. Carpenter, Jr.	34½
Howard S. Gilmour	13
Carl S. Kuebler	9
Patrick A. Dwyer	9

The partnership agreement provided that, in the event Enright died, his interest would consist of his interest upon the above percentage basis in cash, accounts receivable and "the unearned proportion of the estimated receipts from unfinished business." The decedent by his will directed his executors to accept the valuation placed upon partnership items by James D. Carpenter, Jr. The surviving partners formed a new partnership immediately after Enright died and continued the business. The new agreement provided that Carpenter was to estimate the earned portion of receipts from unfinished business for the purpose of paying the Enright estate. (R. 20–21, 39–41.)

At the date of his death, Enright's interest in partnership cash was $4,143.81 and his interest in collectible accounts receivable was $2,055.55. The partnership at that time was handling over 400 pending cases in which work had been done, and on which additional work had to be done before the amount of fees to be charged could be determined and billed to clients. Carpenter estimated that the firm had earned by work upon those cases up to November 19, 1934, about $118,422.51

and that Enright's interest therein was $40,855.77. The $2,055.50 item and the $40,855.77 item, or $42,911.32, were reported as a part of Enright's estate for state and federal estate tax purposes. (R. 21, 42–43.)

The share of Enright in cases being handled upon the basis of a fixed fee was $1,024.89, but those fixed fees were payable after his death upon a monthly or yearly basis. Almost all other cases were being handled under understandings with clients that the fee would be a reasonable amount for work done, taking into account, results, time and effort, and the amount involved. Only a few cases were being handled upon a contingent fee basis and such cases Carpenter valued in his estimate at one dollar. (R. 21, 43.)

As the new firm made collections on old business it paid Enright's share to his estate. (R. 21, 44–48.)

The executors filed a return for Enright for 1934 and included his share of the partnership cash, $4,143.81. The Commissioner, in determining the deficiency, added $42,911.32, representing his share of accounts receivable and his share of estimated earnings to the date of his death. (R. 13, 21, 42.)

The new firm, up to the date of the hearing, had collected $46,293.75 upon Enright's share of old business and had paid $45,965.15 to the estate. (R. 22, 45, 48.)

The following additional facts were found by the Board from testimony of Carpenter (R. 22, 35):

The amount estimated as Enright's share of earned fees on unfinished business would not have been realized in full had the new firm not completed the business.

Enright was on a cash basis and did not receive any of the $42,911.32 in controversy.

The Board of Tax Appeals determined that the decedent's share of partnership profits for the period ending with his death should be included in his gross income for that period (R. 23). On appeal, the Circuit Court of Appeals for the Third Circuit, with Judge Biggs dissenting, reversed the decision of the Board.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the decedent's share of profits earned, but not yet received, by the partnership should not be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

2. In failing to hold that the decedent's share of income earned, but not yet received, by the partnership should be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

3. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the Third Circuit in this case is in direct conflict with the decision of the Circuit

Court of Appeals for the Second Circuit in *Pfaff* v. *Commissioner*, 113 F. (2d) 114.

Both cases arise upon substantially identical facts.[1] In the *Pfaff* case the taxpayer, until the time of his death in December of 1935, was a member of a medical partnership, which had taken over the assets and assumed the liabilities of a prior medical partnership. Each of the partnerships and the taxpayer maintained accounts on a cash basis. At the date of the taxpayer's death, there were accounts outstanding in the amount of $69,601.59 for services rendered to patients during his lifetime. A portion of these accounts was collected during the balance of 1935 and during 1936, and taxpayer's share was paid to his estate. The question presented in the *Pfaff* case, just as in the case at hand, was whether income earned, but not yet received, by the partnerships should be included in the gross income of the partner for the period ending with his death, where both the partnerships and the deceased partner were on a cash basis. The Board of Tax Appeals determined that such income should be included, and the Circuit Court of Appeals for the Second Circuit affirmed *per curiam*.

2. This case raises an important question concerning the construction of Section 42 of the Revenue Act of 1934 with reference to its application

[1] The facts in the *Pfaff case* are taken from the opinion of the Board of Tax Appeals which is a memorandum opinion and therefore not officially reported.

to partnership accounting for income tax purposes. The legislative history of Section 42,[2] as well as its terminology, discloses that Congress thereby intended to tax to the decedent all income earned during his lifetime which, under the prior law, was treated as capital and not income to his estate. Accordingly, it taxed to such decedent amounts "accrued" up to the date of his death.[3] In order to carry out this Congressional purpose, and prevent escape from the income tax, Section 42 should be held applicable to the situation at bar. This is an important question in the administration of the revenues which should be, but probably has not been, determined by this Court. See *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493; *Bull* v. *United States,* 295 U. S. 247.

CONCLUSION

It is therefore respectfully submitted that, for the reasons stated, this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

SEPTEMBER, 1940.

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[2] See H. Rep. No. 704, 73d Cong., 2d Sess., p. 24; S. Rep. No. 558, 73d Cong., 2d Sess., p. 28.

[3] The Board found (R. 22–23) that the taxayer's right to receive the additional amount assessed was sufficiently fixed and determined at his death, *Lucas* v. *American Code Co.*, 280 U. S. 445, and that the amount was ascertainable with reasonable accuracy, *Continental Tie & L. Co.* v. *United States*, 286 U. S. 290, for income-tax accounting purposes.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period. [U. S. C., Title 26, Sec. 42.]

SEC. 48. DEFINITIONS.

When used in this title—

(a) *Taxable Year.*—"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

* * * * *

[U. S. C., Title 26, Sec. 48.]

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. [U. S. C., Title 26, Sec. 181.]

SEC. 182. TAX OF PARTNERS.

There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. [U. S. C., Title 26, Secs. 182, 188.]

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners. [U. S. C., Title 26, Sec. 187.]

New Jersey Revised Statutes (1937, Vol. II, Title 42:

PARTNERSHIPS AND PARTNERSHIP ASSOCIATIONS

ARTICLE 6. DISSOLUTION AND WINDING UP.

42:1-29. *Dissolution defined.*—The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

42:1-30. *Partnership not terminated by dissolution.*—On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

42:1–31. *Causes of dissolution.*—Dissolution is caused:

* * * * *

4. By the death of any partner;

* * * * *

42:1–43. *Right to accounting on dissolution.*—The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners, or the surviving partners, or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary.

Treasury Regulations 86, relating to the Revenue Act of 1934:

ART. 42–1. *When included in gross income.*—Except as otherwise provided in section 42 in the case of the death of a taxpayer, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 41–1 to 41–3.) If a taxpayer has died there shall also be included in computing net income for the taxable period in which he died amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period, regardless of the fact that the decedent may have kept his books and made his returns on the basis of cash receipts and disbursements. * * *

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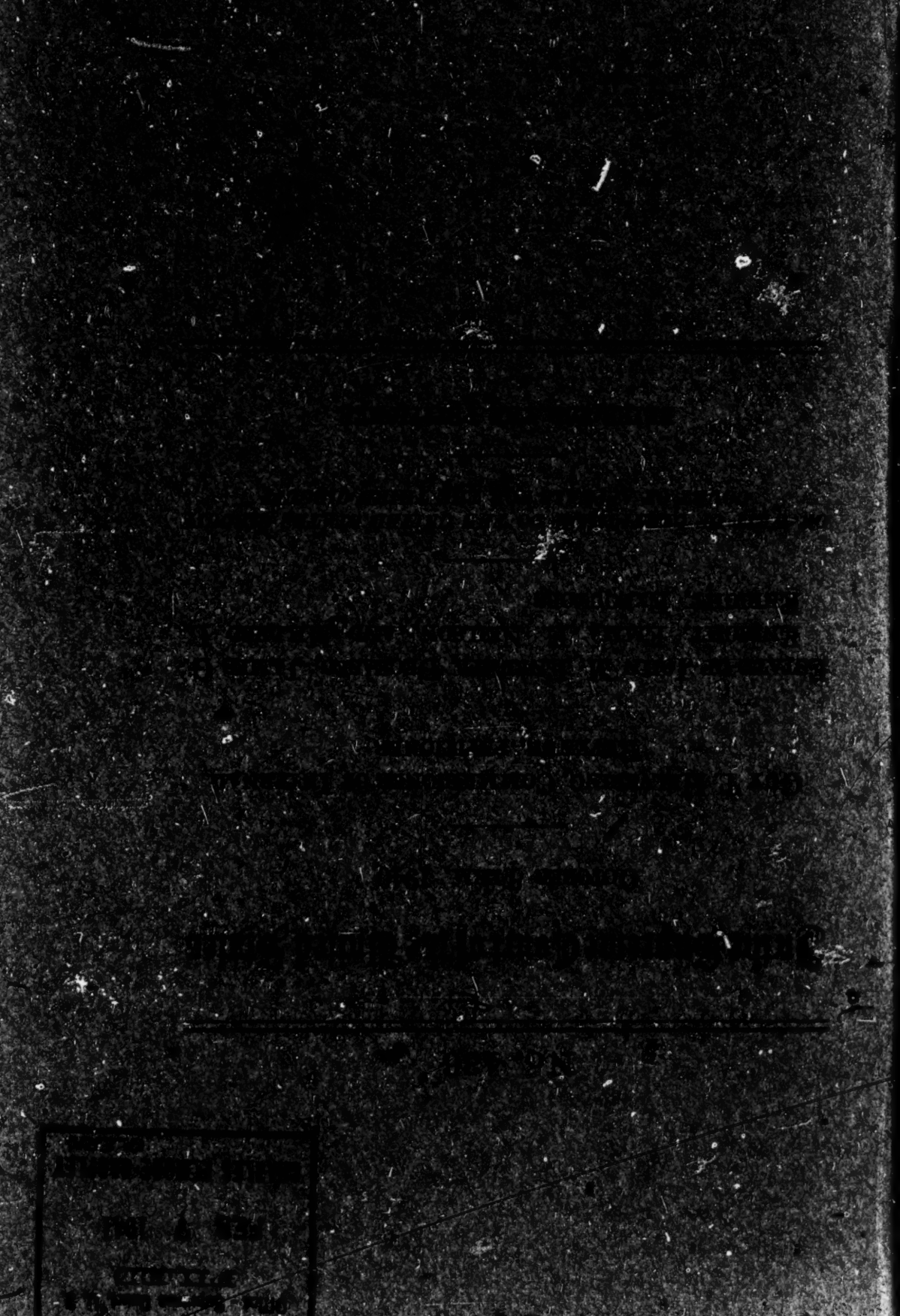

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 436

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JOHN M. ENRIGHT, DECEASED, JAMES G. ENRIGHT, EMMA E. NEILSON, AND MILDRED L. ENRIGHT, EXECUTORS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOF THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 12–15) is not officially reported. The opinion of the Circuit Court of Appeals (R. 34–37) is reported in 112 F. (2d) 919.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 17, 1940 (R. 38). The petition for a writ of certiorari was filed September 14, 1940, and granted November 12, 1940. The juris-

diction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a deceased partner's share of income earned, but not yet received, by the partnership should be included in the gross income of the partner for the taxable period ending with his death, where both the partnership and the partner kept books on the cash basis.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 35–41.

STATEMENT

The relevant facts, as found by the Board of Tax Appeals (R. 13–15) on the stipulation (R. 25–33) and testimony (R. 22–25), may be summarized as follows:

John M. Enright, up to the time of his death on November 19, 1934, was senior partner in the firm of McDermott, Enright & Carpenter, engaged in the practice of law in Jersey City, New Jersey (R. 25). The net income of the partnership, which reported income upon a calendar year cash receipts basis, was distributable as follows (R. 26):

	Percent
John M. Enright	34½
James D. Carpenter, Jr.	34½
Howard C. Gilmour	13
Carl S. Kuebler	9
Patrick A. Dwyer	9

The partnership agreement, in part, read (R. 26):

> (5) In the event of the retirement through death or otherwise of the present members of the firm, Messrs. Enright and Carpenter, or either of them, it is agreed that the interest of such retiring member shall consist of his interest on the above percentage basis in the net monies then in the treasury of the firm, plus his like percentage in the outstanding accounts and the earned proportion of the estimated receipts from unfinished business. The value of such outstanding accounts and unfinished business shall be determined if possible as of the effective date of such retirement, by the joint agreement of such retiring member or his personal representative, and the senior remaining partner. * * *
>
> The amount so determined shall be paid by the remaining members who elect to carry on the firm, in equal monthly instalments, within eighteen months from the date of such retirement.

The decedent by his last will made the following provision (R. 27):

> EIGHTH: In settling my interest in the law firm of McDermott, Enright & Carpenter, I direct my executors to accept the valuation of the various items of business in the hands of the firm as fixed by my partner James D. Carpenter, Jr., and to accept payment for my interest therein upon such terms of

credit as my said partner may deem reasonably necessary for the liquidation thereof out of the business.

The surviving partners formed a new partnership immediately after the death of Enright and continued the practice of law. The new agreement provided that "the earned proportion of the estimated receipts from unfinished business of the former firm shall be determined by the said James D. Carpenter, Jr., whose decision thereon shall be binding and conclusive * * *" (R. 27).

At the date of his death, Enright's interest in partnership cash was $4,143.81 and his interest in collectible accounts receivable was $2,055.55. The partnership at that time was handling over 400 pending cases in which work had been done and on which additional work had to be done before the amount of fees to be charged could be determined and billed to clients. The share of Enright in cases being handled upon the basis of a fixed fee was $1,024.89, payable after his death upon a monthly or yearly basis. Almost all other cases pending were being handled upon understandings with clients that the fee would be a reasonable amount for work done, taking into account results, time and effort, and the amount involved. Only a few cases were being handled upon a contingent fee basis and such cases Carpenter valued in his estimate at one dollar each (R. 28–29). Carpenter determined that the firm had earned by

work upon these cases up to November 19, 1934, about $118,422.51 and that Enright's proportionate share was $40,855.77 (R. 28). The amount estimated as Enright's share of earned fees on unfinished business would not have been realized in full had the new firm not completed the business (R. 14). The $2,055.55 item and the $40,855.77 item, or $42,911.32, were reported as a part of Enright's estate for state and federal inheritance tax purposes (R. 28).

The successor firm did not buy the decedent's interest in the former firm. As it made collections on the business of the old firm it turned Enright's share over to his estate. Up to the date of the hearing the new firm had collected $46,293.75 upon Enright's share of old business and had paid $45,965.15 to the estate (R. 29–32).

The executors filed an income tax return for Enright for 1934 and included only his share of the partnership cash, $4,143.81. The Commissioner determined a deficiency and added $42,911.32, representing Enright's share of accounts receivable and his share of estimated earnings to the date of his death (R. 14). Enright was on a cash basis and did not receive any of the $42,911.32 in controversy (R. 14).

The Board of Tax Appeals determined that the decedent's share of accounts receivable and estimated earnings for the period ending with his death should be included in his gross income for

that period (R. 15). On appeal, the Circuit Court of Appeals for the Third Circuit, with Judge Biggs dissenting, reversed the decision of the Board.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the decedent's share of profits earned, but not yet received; by the partnership should not be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

2. In failing to hold that the decedent's share of income earned, but not yet received, by the partnership should be included in his gross income for the period ending with his death, within the meaning of Section 42 of the Revenue Act of 1934.

3. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The decision in *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493, sets forth the principles that are controlling here. There, the argument was made on behalf of the decedent partner that the income computing and reporting method used by the firm should be conclusive in determining the income attributable to the decedent. This Court rejected the contention. It observed that upon the death of the taxpayer his surviving partners were bound to account to him for the profits as of that date. It then held that the final accounting to as-

certain the decedent's interest, not the periodic firm accounting, is the one determinative of the income of the decedent for the period ending with his death. The case of *Bull* v. *United States,* 295 U. S. 247, sheds further light on the problem. In that case the partnership agreement provided that at its option the estate of decedent could participate in the firm for one year just as the decedent could, if living. Certain profits *earned* both before and after the death of decedent were paid over to his estate. This Court held that the profits *earned* prior to his death were taxable as income earned by the decedent in his lifetime while those *earned* subsequent to his death were taxable as income to the estate. In the case at bar the situation is the same in essential respects. Upon the death of Enright his surviving partners were bound to account for his interest in the firm. Such an accounting was made and his interest ascertained in the cash, outstanding accounts and the earned proportion of the estimated receipts from unfinished business. The firm had no capital and no goodwill accounts. The items ascertained as decedent's share and later liquidated and paid to his estate were derived wholly from personal services performed prior to his death. They are therefore taxable as income earned by him during his lifetime under the *Bull* and *Guaranty Trust* cases.

The same result follows under the provisions of Section 42. The legislative materials make

abundantly clear the purpose of Congress to close the gap in the income tax resulting from a series of decisions that income earned but not received during his lifetime by a taxpayer on a cash basis of accounting was not taxable as income to him and was capital to his estate. In Section 42 Congress remedied the situation by providing, in effect, that there shall be included in computing the gross income of every decedent for the period ending with his death all amounts earned up to the date of his death. There is nothing in the statutory partnership accounting provisions which indicates that income earned in partnership transactions during the decedent's lifetime should, alone, escape the reach of Section 42 and thus escape all taxation as income.

All the items here sought to be taxed as income to the decedent clearly are within the critical words "amounts accrued up to the date of his death" in Section 42. Even under the strictest criteria as to when an item "accrues" the evidence in this case supports the finding of the Board. In addition, the Government urges that the so-called "accrual basis" of accounting has no precise meaning apart from the circumstances of a particular taxpayer's case. The relevant statutory and legislative materials demonstrate that the so-called "accrual basis" means that basis of accounting which truly reflects income. It is apparent, we submit, that all items derived from the personal services of the decedent must be included in his return in order

to reflect accurately the income earned by him in his lifetime. This result is essential to avoid nullification of the purpose of Congress in enacting Section 42 to prevent the escape of any income from taxation as such.

ARGUMENT

A DECEASED PARTNER'S SHARE OF INCOME EARNED, BUT NOT YET RECEIVED, BY A PARTNERSHIP SHOULD BE INCLUDED IN HIS GROSS INCOME FOR THE TAXABLE PERIOD ENDING WITH HIS DEATH

The decedent at the time of his death in November 1934 was practicing law as a member of the firm of McDermott, Enright & Carpenter, a New Jersey partnership. The records of the firm show no capital interest for the partners and no goodwill account. Under the agreement of the partners each one upon retirement from the firm, either through death or otherwise, was to have his interest ascertained, as of the effective date of such retirement, in a manner stated.[1] The interest of decedent upon retirement was to be thirty-four and one-half per centum of the following: the cash

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[1] New Jersey Revised Statutes (1937), Vol. II, Title 42:
42:1-31. *Causes of Dissolution.* Dissolution is caused:

* * * * *

4. By the death of any partner;

* * * * *

42:1-43. ***Right to accounting on dissolution.***—The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners, or the surviving partners, or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary.

then in the treasury, the outstanding accounts, and the earned proportion of the estimated receipts from unfinished business. The decedent's interest in each of these items was ascertained, as of the date of his death, by one of his partners and the amount thus ascertained was paid over to his executors during the years 1934 to 1939 out of the liquidation of the business of the original firm. It is stipulated that the successor law firm did not buy the decedent's interest in the original firm (R. 32). The decedent and the firm kept accounts for income-tax purposes upon a calendar year, cash-receipts basis.

The sole question presented is whether the interest of the decedent in the outstanding accounts and the earned proportion of the estimated receipts from unfinished business, ascertained as of the date of his death, may be included in his gross income for the period ending with his death.

1. (a) The case of *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493, sets forth the principles that are controlling here. There, upon the death in December 1933 of the taxpayer who was a member of a New York partnership, his surviving partners ascertained his share of the profits to the date of his death and in January and February 1934 paid the amount ascertained to his executor. The firm and the taxpayer each kept books for income tax purposes on a cash basis but the firm, unlike the partner, had a fiscal year ending on July 31st rather than a calendar year. It was urged on be-

half of the taxpayer that the income computation on the return of the firm should be conclusive and, since the firm reported income for the preceding 12 months only on July 31st, that no income derived through firm transactions after July 31, 1933, should be included in the gross income of the decedent taxpayer for the period prior to his death in December 1933. The basis of the contention was that under the partnership accounting provisions of the applicable revenue act only the distributive share of the firm's net income "for any taxable year of the partnership ending within his taxable year" was to be included in computing the income of the partner.

The contentions advanced in this case on behalf of the decedent taxpayer are similar in essential respects to those made in the *Guaranty Trust* case. Here, too, the argument is made that the income computing method used by the firm should be determinative and, since the outstanding accounts were not reported as income during 1934 to the firm on a cash receipts basis, that the interest of the decedent in the accounts cannot possibly be income to him either.

The answer given by this Court in the *Guaranty Trust* case is applicable to the case at bar. The system of reporting periodic income used by the firm is not determinative because, upon his death, the decedent's interest in the income derived through his personal services in conjunction with those of his partners is ascertained in a single, final

accounting.[2] This rationale is implicit in the decision. In that very case, for example, if the firm system of computing income were controlling the decedent's distributive share of the income earned between July 31st and December would never have "accrued" to him within his taxable year. It would not have been ascertained until the next accounting period of the firm.[3] This Court rejected the argument. It held that the final accounting to ascertain the decedent's interest, not the periodic firm accounting, is the one determinative of the income "accrued" to the decedent up to the date of his death (303 U. S. at 499).

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[2] The New York Partnership Act involved in the *Guaranty Trust* case (303 U. S. at 495n.) is identical in relevant part with the New Jersey statutes involved here (pp. 39–41, *infra*). The Court stated (303 U. S. at 495):

"Both by the practical construction given to the partnership agreement by petitioner and the surviving partners, and by the applicable provisions of the New York Partnership Act,[a] decedent's death dissolved the partnership, terminated his right to share in the profits, and fixed the date as of which the surviving partners were bound to account for the profits. *Darcy* v. *Commissioner*, 66 F. (2d) 581. Decedent's estate in fact received the profits accrued on the date of his death, and partnership profits thus accrued and distributable by reason of the death of a partner are his income, taxable as such. *Bull* v. *United States*, 295 U. S. 247.

[a] New York Partnership Act, Laws of 1919, c. 408.

[3] At the next accounting period, July 31, 1934, the firm in liquidation might have reported zero income as a result of losses sustained in the period from December 1933 to July 31, 1934. Compare *Heiner* v. *Mellon*, 304 U. S. 271. Even so, we submit, the result in the *Guaranty Trust* case would have been the same. Therefore, the periodic firm report of income must be irrelevant in this situation.

It is not material that the decedent's interest ascertained on a final accounting should ever have been distributable to him during his lifetime. This Court observed in the *Guaranty Trust* case that the amount of the decedent's interest was not paid until January of the year following death and the Circuit Court of Appeals (89 F. (2d) at 692), which was affirmed, stated that no profits earned after July 1933 were received or were receivable by the decedent up to the time of his death. The basis of this Court's decision in this respect was stated thus (303 U. S. at 496): "Decedent's estate in fact received the profits accrued on the date of his death, and partnership profits thus accrued and distributable by reason of the death of a partner are his income, taxable as such. *Bull* v. *United States*, 295 U. S. 247."

The *Bull* case sheds further light on this matter. There, the decedent was a member of a personal service partnership in which no capital had been invested by the members and which owned no interest in tangible property. The agreement provided that his estate at its option could participate in the firm for a year to the same extent as the decedent could, if living. His share of profits *earned* prior to his death in February 1920 was $24,124.20; the profits *earned* after his death to the end of 1920, and paid to his estate as a member of the partnership (either the old firm or a new associa-

tion) amounted to $212,718.99 (295 U. S. at 255–256). This Court declared (295 U. S. at 254):

> We concur in the view of the Court of Claims that the amount received from the partnership as profits earned prior to Bull's death was income earned by him in his lifetime and taxable to him as such; and that it was also corpus of his estate and as such to be included in his gross estate for computation of estate tax. We also agree that the sums paid his estate as profits earned after his death were not corpus, but income received by his executor and to be reckoned in computing income tax for the years 1920 and 1921.

The import of this language has a direct bearing on the case at bar. In effect the Court held that the death of the partner results in a sharp break between transactions prior to his death and those after. Income *earned* in transactions prior to his death is treated as income earned by the decedent in his lifetime. But income *earned* in transactions subsequent to the decedent's death is taxed to those who participate in them.

The partnership agreement in the case at bar shows that the decedent taxpayer's interest ascertained at death consisted exclusively of earnings created by the activities of himself and his partners prior to his death. The cash and the outstanding accounts clearly had been all earned prior to the date of decedent's death. And, as for the

unfinished business, only so much entered into the computation of his share as consisted of "the earned proportion of the estimated receipts" (R. 26). These items were ascertained to be owing to the decedent as a result of his services performed as a practicing attorney and, therefore, they are all clearly within the definition of income in Section 22 (a) as including "compensation for personal service." See *Irwin* v. *Gavit*, 268 U. S. 161, 166. It follows that the principles stated in the *Guaranty Trust* and *Bull* cases are determinative of the present controversy.

(b) In the *Guaranty Trust* case and, perhaps, in the *Bull* case,[4] the decedent taxpayer's interest ascertained at death was derived from transactions on which payment had been made to the firm. This fact, of course, forms the basis for a contention on behalf of the taxpayer here that the payments in those cases had become income to the firm upon receipt while the outstanding accounts in the case at bar had not become income to the firm prior to receipt. This is urged as a vital distinction. The argument is made that the decedent here cannot be taxed for amounts that have not yet become income to the firm under its system of computing income, since that is the controlling factor. The

[4] The opinion of this Court does not state whether the partnership was on a cash or accrual basis or whether it had received payment for the services rendered. The opinion refers to "the amount received from the partnership as profits earned prior to Bull's death" (295 U. S. at 254).

corrollary of the argument is that all the accrued items would have been taxable to the decedent provided the firm in this case had reported its income upon an accrual basis.

We agree on the latter point. If the firm had been on an accrual basis for reporting income, the decedent's share of the outstanding accounts and other accrued items would clearly be taxable to him. See *Clarence B. Davidson,* 20 B. T. A. 856, affirmed *per curiam,* 54 F. (2d) 1077 (C. C. A. 2d); *Beverly W. Smith,* 26 B. T. A. 778, dismissed on procedural grounds, 67 F. (2d) 167 (C. C. A. 4th). But it certainly does not follow that the items not reported as income under the firm's income computing system cannot be included in the income reported as earned by the decedent up to his death. Any such contention, we submit, is contrary to the *Guaranty Trust* and *Bull* decisions.

The practical implications of the taxpayer's contention may well be considered. It is worthy of note that the basis for reporting firm income has no bearing upon the extent or the character of the decedent's interest or upon the time of payment to him. His share of the cash, accounts receivable, and the earned proportion of the estimated receipts from unfinished business would be ascertained in the same amount and paid out of the liquidation of the business of the old firm within the same time whether the firm used the cash or the accrual basis for reporting income. Since the practical inci-

dents of the final accounting upon the taxpayer's death are unaffected by his firm's system of reporting periodic income, the fact that his firm was on a cash basis appears to be an irrelevancy. The Government contends that the practical incidents of the situation should be controlling.

The difference for income reporting purposes between an annual accounting and a final accounting resulting from the death of a partner is significant. The provisions of the 1934 Act with respect to the computation and reporting of income derived through partnership transactions are derived from the system adopted in the Revenue Act of 1918.[5] Congress there provided that the income from firm transactions might be computed by the firm in the same manner as in the case of an individual and his proportionate share thereof included in computing the income of each member. The tax is levied upon each partner in his individual capacity and is computed only upon his individual income. This system has been followed in all succeeding revenue acts.[6] Such annual income accountings by

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[5] The 1916 Act, Section 8 (e), contained different provisions with respect to the reporting of profits by the partnership (see p. 26, *infra*).

[6] See 1934, 1932, 1928 Acts, Sections 181–182; 1926, 1924, 1921, 1918 Acts, Section 218 (a). The Revenue Acts of March 3, 1917, Section 201, and of October 3, 1917, Section 201, for a time placed an excess profits tax on partnerships as such in addition to the income tax on partners only in their individual capacity. This tax was abandoned the following year. See *Burnet* v. *Leininger*, 285 U. S. 136, 142.

the firm if continued until complete liquidation of firm transactions during the life of all the partners will, on the whole, come reasonably close to showing the practical economic consequences to each member flowing from such transactions. By including his proportionate share of the income so reported in computing his annual individual income each member thus pays a tax upon what actually and practicably may be regarded as his entire income from firm transactions. But the death of a member prior to liquidation of the affairs of the firm disturbs this relationship between the income reported by the firm and included in computing the member's income and the practical economic consequences to him flowing from firm transactions. The reason for this is obvious. Income reported on the return of the firm in years after the member's death is not included in computing his income, for after death he has none. Therefore, the income from firm transactions earned during his life and distributable by reason of his death either must be included in computing his income for the period ending with his death or it will never be included in computing his income.

Considerations such as these appear to be the real basis for the decision in the *Guaranty Trust* case rejecting the firm's annual income reporting system as the determining factor for computing the income of a decedent up to his death. It can, therefore, scarcely be material in this case whether the

firm is on a cash or accrual basis for reporting income. In this instance, just as in the *Guaranty Trust* case, the taxpayer is relying upon the firm system of accounting to avoid income taxation upon earnings derived and eventually paid over to his estate as a result of services rendered during his life. The purpose of Congress to tax to him who produces it all income derived as compensation for personal services can neither be overlooked nor so lightly cast aside. See *Irwin* v. *Gavit,* 268 U. S. 161, 166; *Lucas* v. *Earl,* 281 U. S. 111, 115. Compare *Helvering* v. *Horst,* No. 27, this Term. Under the *Bull* and *Guaranty Trust* cases, we submit, the earnings from services rendered prior to the death of the decedent are income earned by him in his lifetime and taxable as such.

2. (a) The situation before the Court may be considered from yet another point of view. Under the Estate Tax the interest of the decedent in the cash on hand, accounts receivable, and the earned proportion of unfinished business would clearly be included in determining the value of his gross estate. The items enumerated are well within the meaning of the words "property, real or personal, tangible or intangible, wherever situate" as used in the revenue acts. See *Burnet* v. *Houston,* 283 U. S. 223, 226; *United States* v. *Carter,* 19 F. (2d) 121 (C. C. A. 5th); *Nichols* v. *United States,* 64 C. Cls. 241, certiorari denied, 277 U. S. 584.

A series of cases in the Board of Tax Appeals and in the circuits courts of appeals has held that

similar items included in the gross estate of a decedent are capital, not income to the estate.[7] Thus obligations forming part of decedent's assets—such as for interest [8] and for salary earned during his life,[9] for rents accrued during his life,[10] and for dividends declared during his life but payable after his death [11]—are treated as capital and not as

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[7] See the cases collected in Paul & Mertens, *The Law of Federal Income Taxation*, Vol. 4, Sections 34.34–34.35. Only the excess collected over the value of the item at the date of death is taxable as income to the executor or the beneficiaries of the estate. *Eldredge* v. *United States*, 31 F. (2d) 924 (C. C. A. 6th); *William P. Blodgett et al., Exec.*, 13 B. T. A. 1243; *Estate of A. Plumer Austin*, 10 B. T. A. 1055; *Walter R. McCarthy, Exec.*, 9 B. T. A. 525; *Frank H. Clark, Exec.*, 12 B. T. A. 425. Cf. Sections 113 (a) (13), 113 (a) (5), Revenue Act of 1934; Article 113 (a) (13)–2, Treasury Regulations 86.

[8] *Mellie Esperson Stewart*, 18 B. T. A. 1010; *Frank H. Clark, Exec.*, 12 B. T. A. 425; *William K. Vanderbilt, Exec.*, 11 B. T. A. 291; *E. S. Heller, Exec.*, 10 B. T. A. 53; *William G. Frank, Adm.*, 6 B. T. A. 1071.

[9] *Jackson B. Kemper, Adm.*, 14 B. T. A. 931; *Frank H. Clark, Exec.*, 12 B. T. A. 425; *J. Howland Auchencloss, Exec.*, 11 B. T. A. 947; *Estate of A. Plumer Austin*, 10 B. T. A. 1055; *George Nichols et al., Exec.*, 10 B. T. A. 919 *Walter R. McCarthy, Exec.*, 9 B. T. A. 525.

[10] *Frank H. Clark, Exec.*, 12 B. T. A. 425; *William K. Vanderbilt et al., Exec.*, 11 B. T. A. 291.

[11] *Grahame and Richard D. Wood, Exec.*, 26 B. T. A. 533; Cf. *Clarence B. Davison, Exec.*, 20 B. T. A. 856, aff'd, 54 F. (2d) 1077 (C. C. A. 2d); GCM 6658, CB VIII–2, p. 309; *Wm. P. Blodgett et al., Exec.*, 13 B. T. A. 1243; *George Nichols et al., Exec.*, 10 B. T. A. 919; see also *Maurice L. Goldman*, 15 B. T. A. 134; *Nichols* v. *United States*, 64 C. Cls. 241 (1927), certiorari denied, 277 U. S. 584.

income to his estate when it receives payment. The same rule has been applied to the interest of a decedent partner in earnings derived from personal services rendered by his firm prior to his death. *Nichols* v. *United States,* 64 C. Cls. 241, certiorari denied, 277 U. S. 584. Compare *United States* v. *Carter,* 19 F. (2d) 121 (C. C. A. 5th).

The *Nichols* case arose upon facts strikingly like those here before the Court. The decedent there at the time of his death on April 25, 1920, was a member of a copartnership operating in New York as selling agents on commission. The articles provided that—

> In case of the death of any partner, his interest in the partnership shall cease with the last day of the month in which he dies and * * * shall be liquidated and paid over to his estate as fast thereafter as the proper conduct of the business will allow [64 C. Cls. at 244].

During the decedent's life, the firm performed some services, namely, it secured certain contracts. The commissions owing on these services were paid to the firm subsequent to the decedent's death—between April 25 and December 31, 1920—and were turned over to the decedent's estate as received. The Court of Claims held that the payments were received by the estate as capital, and need not be reported as income to it for the period April 25 to December 31 (64 C. Cls. at 245-246). This Court denied certiorari. 277 U. S. 584.

It was not considered material, in any of the cited cases, whether the decedent had been on a cash or accrual basis or whether the obligations forming part of his assets had ever been reported by him as income. The theory adopted in the cases was that income to the estate is only such income as is earned after the estate begins, i. e., after the decedent's death. Compare *Nichols* v. *United States,* 64 C. Cls. 241, 245, certiorari denied, 277 U. S. 584, with *Bull* v. *United States,* 295 U. S. 247, 255–256, wherein the income earned after the decedent's death, and paid to the estate as a member of the firm, was taxed to the estate, and income earned prior to his death was taxed as income to him and treated as capital to his estate.

The result of these decisions was that such items of income either had to be taxed to the decedent as income earned during his life or they escaped all taxation as income. Yet it was uniformly held (except as to the interest of a decedent in partnership earnings during his life, *Bull* v. *United States,* 295 U. S. 247) that income earned by an individual but not received during his life was not income to him in the event his books were kept on a cash receipts basis. Thus there was created a considerable breach in the income tax statutes contrary to the purpose of Congress to tax all income from whatever source derived. Compare *Irwin* v. *Gavit,* 268 U. S. 161, 168. Congress was thereupon asked to remedy the situation.

The method chosen by Congress was to declare in the Revenue Act of 1934, in effect, that income earned during the life of a decedent should be taxed as income to him during his life without regard to the fact that payment was made after death or that his books were kept on a cash receipts basis. Section 42 of the Act reads as follows:

> In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period. [U. S. C., Title 26, Sec. 42.]

There is no doubt either as to the circumstances which gave rise to this section or as to the purpose which Congress intended to accomplish. The legislative materials make both abundantly clear. The Report of the House Ways and Means Committee (H. Rep. No. 704, 73d Cong., 2d Sess., p. 24) states:

> *Sections 42 and 43.* Income accrued and accrued deductions of decedents: The courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death cannot be deducted by the estate. Section 42 has been drawn to require the inclusion in the income of a dece-

> dent of all amounts accrued up to the date of his death regardless of the fact that he may have kept his books on a cash basis. Section 43 has also been changed so that expenses accrued prior to the death of the decedent may be deducted.

The Report of the Senate Finance Committee (S. Rep. No. 558, 73d Cong., 2d Sess., p. 28) reads:

> *Sections 42 and 43. Period for which deductions and credits taken.*—The courts have held that income accrued prior to the death of a decedent on the cash basis is not income to his estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death cannot be deducted by the estate. Sections 42 and 43 of the House bill were so drawn as to require the inclusion in the income-tax return for the decedent of all items of income and deductions accrued up to the date of death regardless of the fact that the decedent may have kept his books on a cash basis. The change made in section 43 is necessary to effectuate the policy adopted in the House bill in section 42. By reason of the proposed change such items as accrued dividends and interest on partially tax-exempt securities are permitted as a credit in computing the normal tax.

The legislative materials cited thus confirm the meaning urged by the Government and show that

the purpose of Congress in enacting Section 42 was to reach all income earned during the life of a decedent that otherwise would escape the income tax whether derived from services performed as an individual or as a member of a partnership. The reference in each report to court opinions is plainly a reference to such cases, among others, as *Nichols* v. *United States,* 64 C. Cls. 241, certiorari denied, 277 U. S. 584, dealing with partnership earnings. The basis for this assertion is the fact that the *Nichols* case has been viewed by the Board as a leading authority and was strongly relied upon in support of its earlier decisions.[12] It is improbable that Congress in these circumstances could have intended that income earned during his life by a decedent as a member of a partnership should, alone, escape the reach of Section 42 and avoid being taxed as income. See *Irwin* v. *Gavit,* 268 U. S. 161, 168.

The income sought to be taxed to the decedent in the case at bar comes well within the principles announced in the *Nichols* case and therefore comes within reach of Section 42.

(b) There is nothing in the statutory provisions with respect to partnership income computation and reporting which militates against the Government's position. The historical development of these provisions indicates that partnership returns are merely informational and accounting conven-

[12] See cases cited in notes 8–11, *supra*, p. 20.

iences. The relevant section of the 1916 Act[13] provided that—

> Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid * * *.

It is noteworthy, however, that there was no provision for a single annual partnership return of its income transactions. The 1916 Act, on the contrary, declared that——

> * * * such partnership, when requested by the Commissioner of Internal Revenue, or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, * * * setting forth the item of the gross income and the deductions and credits allowed by this title, and the names and addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed.

Under these provisions, partnerships might be subjected to the considerable inconvenience of rendering a statement of earnings several times during a twelve-month period. The 1918 Act was therefore framed to avoid the difficulties experienced under the 1916 Act. The system of reporting partnership income then erected has been followed in all reve-

[13] C. 463, 39 Stat. 756, Section 8 (e).

nue acts since that time.[14] This system, briefly, provides that the income of a firm of partners shall be computed as in the case of an individual and that the distributive share of the net income of the firm whether distributed or not, shall be included in computing the net income of each partner. The firm is required to "make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed * * * [and] the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual."[15]

In the *Guaranty Trust* case this Court considered and rejected the argument that these provisions for reporting partnership income were determinative and could be used to avoid a tax upon income earned during life by a decedent as a member of a partnership even though such income might not appear on any firm return ending within his taxable year (pp. 11-12, *supra*).[16]

The recent decision of the Court in *Neuberger* v. *Commissioner*, No. 5, this Term, sheds further light on the function of the partnership income computing and reporting system. There, a deduction from gross income was allowed for losses from sales or exchanges of stocks and bonds held less than two years but only to the extent of the gains

[14] See note 5, *supra*, p. 17.

[15] E. g., Sections 181-189, Acts of 1934, 1932, 1928, 1926.

[16] See note 3, *supra*, p. 12.

from similar sales or exchanges. The Commissioner urged that losses sustained in an individual capacity could not be offset against gains from similar transactions on the part of the firm in view of the provisions for a separate computation of firm income and individual income. This Court held that the partnership income accounting provisions were not controlling since to permit such an offset was in accordance with the intention of Congress. The intention of Congress in Section 42 to reach the income here sought to be taxed is shown by very convincing evidence. It is therefore immaterial that Section 42 does not expressly modify the partnership accounting provisions of the 1934 Act. The latter must give way to the general purpose of Congress that income earned during the life of decedent shall not escape taxation as his income.

3. The Board found that the decedent's share of the outstanding accounts and the earned proportion of unfinished business came within the words "amounts accrued up to the date of his death" in Section 42 (R. 15). On the record in this case the Board's finding is unassailable. The outstanding accounts on the books of the firm clearly would be viewed as accrued under any system of accrual accounting. *Continental Tie & L. Co.* v. *United States*, 286 U. S. 290, 296. The only problem arises in connection with the earned proportion of receipts from unfinished business. The evidence as to the latter may be briefly reviewed (see Statement, *supra*, pp. 4–5).

At the date of decedent's death his firm was handling 400 pending cases on which work had been done and on which additional work had to be done before the fees to be charged could be determined and billed to clients. The surviving senior partner of the firm, James D. Carpenter, Jr., appraised each case and determined that the probable amount earned by the firm, up to the date of decedent's death, aggregated $118,422.51 of which decedent's share was 34½% or $40,855.77. Nine of the cases pending in the firm were being handled on a fixed fee basis, payable per month or per annum after his death, and the decedent's share in the amounts earned prior to his death was $1,024.89. All contingent fee cases were valued at one dollar each. Substantially all of the remaining matters pending were being handled upon understandings with clients that the fee would be a reasonable amount for work done, taking into account results, time and effort, and the amount involved. The actual collections up to the date of trial exceeded the amount estimated as the aggregate value of the 400 pending cases.

The Board observed (R. 15) that "the share in the fixed fee items were certainly accruable. The evidence does not show the situation in regard to the other items making up the $40,855.77 in sufficient detail to enable the Board to determine whether or not they were accruable. Some of them may have been sufficiently definite to permit an accrual, while others may have been too indefinite or con-

tingent. We must decide the case upon the record before us. That record does not show that any of the estimated fees were too indefinite for accrual of the amount fixed by Carpenter and consequently we are unable to say that less than $42,911.32 [$2,055.55 was from accounts outstanding] was income under section 42."

(a) The Board's opinion (R. 15) cites the case of *Lillian O. Fehrman, Executrix,* 38 B. T. A. 37, likewise involving Section 42, and thus indicates that in reaching its conclusion it relied upon the concepts of accrual income accounting stated therein. The criteria discussed and applied in the *Fehrman* case and applied in the case at bar clearly come within the narrowest definition of the accrual basis of accounting. The *Fehrman* opinion indicates that the Board construes Section 42 as requiring not only that the right to receive items taxed as income to a decedent shall be fixed at the date of his death but also that the amount shall be definitely ascertainable on the basis of the facts then known (38 B. T. A. at 42). These criteria are surely as rigid as any that this Court has ever laid down with respect to ascertaining whether items have accrued for the purpose of making a periodic report of income. E. g., *Continental Tie & L. Co.* v. *United States,* 286 U. S. 290; *American National Co.* v. *United States,* 274 U. S. 99; *United States* v. *Anderson,* 269 U. S. 422. The rule of law thus applied by the Board scarcely can be thought prejudicial to the decedent taxpayer.

The application of this governing rule of law in the circumstances of this case therefore presented only a question of fact within the competence of the Board to decide. The evidence shows that the right to receive payment in some amount on the cases handled on a *quantum meruit* basis had clearly become fixed by the date of decedent's death. It also shows that the aggregate amount then ascertained as having been earned was in fact received with a sum to spare. We submit, therefore, that the evidence supports the finding as made. The taxpayer, in any case, can scarcely be deemed to have met the burden of proving that the Commissioner's deficiency determination was wrong. See *Burnet* v. *Houston*, 283 U. S. 223.

(b) In addition, the Government contends that the criteria for determining whether an item has "accrued" under Section 42 are not nearly so rigid as the Board's opinion here and in the *Fehrman* case would indicate. The term "accrued" as used in the 1934 Act is not defined with particularity. Section 48 (c) states that "The terms 'paid or incurred' and 'paid or accrued' [in Section 43] shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." Under the general rule stated in Section 41 the computation of net income "shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income" (pp. 35–37, *infra*). Article 41–1 of Regulations 86 likewise states that "the time as

of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income" (p. 40, *infra*). Similar provisions have appeared in every revenue act and the regulations promulgated thereunder since the Revenue Act of 1918.[17] Even the optional provisions of the 1916 Act were given a similar construction. See *United States* v. *Mitchell*, 271 U. S. 9, 12; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92, 98. In view of this history, the so-called "accrual basis" of computation can scarcely be deemed to have any precise meaning apart from the circumstances of a given taxpayer's case. It is merely a short-hand expression for designating that manner of computation permitted by the Commissioner in order to achieve a clear reflection of a taxpayer's income as contrasted with the "cash basis" which, though concededly inaccurate, is allowed in some instances in the interests of convenience. See *United States* v. *Anderson*, 269 U. S. 422, 436–438; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92, 96–99.

Section 42 cannot fairly be construed without reference to this historical background of the statutory provisions requiring the so-called accrual

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[17] See 1934, 1932, 1928 Acts, Section 41; 1926, 1924, 1921, 1918 Acts, Section 212 (b); Regulations 86, Articles 41–1, 41–3; Regulations 77 and 74, Articles 321, 323; Regulations 69, 65, 62, 45, Articles 22, 24.

basis of computing net income. When viewed in this setting the critical word "accrued" in Section 42 assumes its proper meaning. It then ceases to connote a specific, arbitrary set of criteria. It no longer compels the determination of every case by some procrustean rule. The words "amounts accrued up to the date of his death" when viewed as part of the whole picture come to mean amounts which clearly reflect the taxpayer's entire income up to the date of his death. This construction is not only in complete accordance with the background of the "accrual basis" and with the general purpose of Congress to tax all income from whatever source derived. *Irwin* v. *Gavit,* 268 U. S. 161, 166. Compare *Lucas* v. *Earl,* 281 U. S. 111, 115; *Helvering* v. *Horst,* No. 27, this Term. It may fairly be deemed essential to avoid nullification of the purpose described with particularity in the legislative materials bearing on the enactment of Section 42 (pp. 23–25, *supra*). Those materials show beyond question that the motivating cause of Section 42 was a group of decisions permitting certain income to escape taxation as such (pp. 23–25, *supra*). It would be anomolous to hold that Congress has again failed to accomplish what it obviously intended.

The income sought to be taxed to the decedent in this case clearly comes within the meaning thus attributable to Section 42. All of the items assessed by the Commissioner were earned through the efforts of the decedent and his partners as

practicing attorneys and the share thus attributed to the decedent may fairly be viewed as compensation for his personal services during his lifetime. The right of the decedent to appoint these items by will or to transfer them by deed of gift or for an immediate cash consideration cannot be doubted. Compare *Helvering* v. *Hurst*, No. 27, this Term. In every real sense these items created by his own efforts and subject to his disposition during his life are income earned by him during his life. We submit that under Section 42 they should not be permitted to escape taxation as such.

CONCLUSION

It is submitted that, for the foregoing reasons, the decision of the Circuit Court of Appeals is erroneous and should be reversed with directions to affirm the decision of the Board of Tax Appeals.

Respectfully,

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FEBRUARY, 1941.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 4 per centum of the amount of the net income in excess of the credits against net income provided in section 25.

* * * * *

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period (U. S. C., Title 26, Sec. 42).

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable

year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

* * * * *

SEC. 48. DEFINITIONS.

When used in this title—

(a) *Taxable Year.* — "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

* * * * *

(c) *Paid, incurred, accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(U. S. C., Title 26, Sec. 48.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity (U. S. C., Title 26, Sec. 181).

SEC. 182. TAX OF PARTNERS.

There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year (U. S. C., Title 26, Secs. 182, 188).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual.

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners (U. S. C., Title 26, Sec. 187).

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

(a) *General rule.*—If the taxable year of a partner is different from that of the partnership, the distributive share of the net income of the partnership to be included in computing the net income of the partner for his taxable year shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1934) ending within the taxable year of the partner.

* * * * *

New Jersey Revised Statutes (1937), Vol. II, Title 42:

PARTNERSHIPS AND PARTNERSHIP ASSOCIATIONS

ARTICLE 6. DISSOLUTION AND WINDING UP.

42:1-29. *Dissolution defined.*—The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

42:1-30. *Partnership not terminated by dissolution.*—On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

42:1-31. *Causes of dissolution.*—Dissolution is caused:

* * * * *

4. By the death of any partner;

* * * * *

42:1-43. *Right to accounting on dissolution.*—The right to an account of his interest shall accrue to any partner, or his legal representative, as against the winding up partners, or the surviving partners, or the person or partnership continuing the business, at the date of dissolution, in the absence of any agreement to the contrary.

Treasury Regulations 86, relating to the Revenue Act of 1934:

ART. 41-1. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year.

Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 42–1 to 42–3.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 41–3. *Methods of accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. * * *

ART. 42–1. *When included in gross income.*—Except as otherwise provided in section 42 in the case of the death of a taxpayer, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different pe-

riod in accordance with the approved method of accounting followed by him. (See articles 41–1 to 41–3.) If a taxpayer has died there shall also be included in computing net income for the taxable period in which he died amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period, regardless of the fact that the decedent may have kept his books and made his returns on the basis of cash receipts and disbursements. * * *

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CLERK

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 436.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

ESTATE OF JOHN M. ENRIGHT, deceased, JAMES G. ENRIGHT, EMMA E. NEILSON and MILDRED L. ENRIGHT, Executors.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENTS IN OPPOSITION.

JAMES D. CARPENTER, JR.,
Of Counsel with Respondents.

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

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Supreme Court of the United States

No. 436, October Term, 1940.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Estate of John M. Enright, deceased, James G. Enright, Emma E. Neilson and Mildred L. Enright, Executors.	On Petition for Writ of Certiorari to the Circuit Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENTS IN OPPOSITION.

Opinion Below.

The opinion of the Circuit Court of Appeals is reported in 112 Fed. (2d) 919.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 17, 1940. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

(1) Whether a partner's share of the estimated value of the gross assets of a partnership, consisting of legal services rendered, the value of which is neither known or due and payable to the partnership, should be included in

the gross income of the partner for the period ending with his death under Section 42 of the Revenue Act of 1934, where both the partnership and the deceased partner were on the cash basis.

(2) Whether the words "income accrued", as used in Section 42 of the Revenue Act of 1934, include in their meaning a deceased partner's interest in the gross assets of a law partnership, where such assets consist of legal services partly rendered and do not constitute an accrual to the partnership even if it maintains its books of account on an accrual basis.

Statutes and Regulations Involved.

Revenue Act of 1934, C. 277, 48 Stat. 680:

Subtitle A—Introductory Provisions.

* * * * * * *

"SEC. 4. SPECIAL CLASSES OF TAXPAYERS.

The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estate and trusts and the beneficiaries thereof —Supplement E.

(b) Members of partnerships,—Supplement F.

(c) Insurance companies,—Supplement G.

(d) Nonresident alien individuals;—etc." (U. S. C. A. Title 26, Sec. 4.)

Subtitle B—General Provisions.

* * * * * * *

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period (U. S. C. A. Title 26, Sec. 42)."

Subtitle C—Supplemental Provisions.

* * * * * *

Supplement F—Partnerships.

"SEC. 181. PARTNERSHIP NOT TAXABLE. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity (U. S. C. A. Title 26, Sec. 181).

"SEC. 182. TAX OF PARTNERS. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year (U. S. C. A. Title 26, Sec. 182).

"SEC. 183. COMPUTATION OF PARTNERSHIP INCOME. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual (U. S. C. A. Title 26, Sec. 183)."

Statement.

A few facts in addition to those mentioned in the Government's petition should be before the Court

Shortly after Enright's Executors qualified, they and the senior surviving partner made a survey of decedent's assets. They then agreed that the interest of Enright in

his law partnership should be liquidated case by case, and the amount of his interest should be paid to the executors from time to time, at the convenience of the successor firm. That was done (R., pp. 35, 43, par. 10).

The senior surviving partner appraised the accounts receivable of the firm and decedent's interest in the unfinished cases in the office for the purposes of estate taxes (R., p. 36). Practically all matters in the office were being handled on the *quantum meruit* basis. The appraisal was completed in November, 1935 (R., p. 37).

There were approximately four hundred matters in the office. Some of them were on appointment by the court to represent receivers, trustees and administrators, and in such matters the fees are fixed by order of the court after the work has been done (R., p. 36).

The appraisal that was thus made for Federal estate and transfer inheritance tax purposes of the value of Enright's interest in his firm, was $42,911.32. In making the assessment the Commissioner held that this amount "has been included in the gross income of the decedent as income accrued up to the date of his death, under the provisions of Section 42 of the Revenue Act of 1934" (R., p. 13, par. (b)).

As each case was closed and the fee paid, the senior surviving partner re-examined the charge sheets to ascertain whether the amount originally determined as the interest of Enright therein to the date of death was correctly stated. In fifty-five separate cases the amount was increased; in twenty cases the amount estimated was decreased (R., p. 47).

The interest of decedent at the date of death in the cash on hand in the firm bank accounts was $4,143.81, which was included in the income tax return filed by the executors for the calendar year 1934 as income accrued to the date of

death and the tax was paid thereon, although said sum was not actually distributed by the successor firm to the executors until February 26, 1935 (R., p. 42, par. (6)).

REASONS FOR DENYING THE WRIT.

I.

The Decision of the Circuit Court of Appeals for the Third Circuit is in conformity with the letter, purpose and intent of the Revenue Act.

The deficiency assessment in this case results from the inclusion, by the Commissioner of Internal Revenue, in the gross income of decedent for the year 1934 of

(a) His interest in the accounts receivable of the partnership, and

(b) His estimated interest in fees earned in whole or in part by the partnership, but not billed to or received from clients of the partnership.

In making this assessment, the Commissioner contends that the above interests of decedent constitute amounts accrued to decedent up to the date of his death within the meaning of the 1934 Amendment to Sec. 42 of the Revenue Act, which reads:

> "In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period."

The partnership kept its books of account on a cash basis, as did decedent. The partnership agreement ex-

pressly provided that the individual partners should receive from the partnership only their share of the actual cash collected by the partnership.

The inclusion in the gross income of decedent of his interest in the accounts receivable of the partnership in effect required the partnership as such to change its books of account from a cash basis to an accrual basis.

The inclusion in the gross income of decedent of his interest in fees earned in whole or in part by the partnership, but not billed to or received from clients of the partnership, in effect required the estate of decedent to report as accrued income that which was not in fact even accrued income to the partnership under any method of accounting.

The Board of Tax Appeals affirmed the action of the Commissioner in a memorandum opinion, which was reversed by the Circuit Court of Appeals for the Third Circuit in 112 Fed. (2d) 919.

In its opinion, the Third Circuit Court of Appeals agreed with the Board of Tax Appeals that the effect of Section 42 of the Revenue Act "was to require that deceased be placed upon an accrual basis at the date of his death", and held that as a necessary consequence of this effect:

> "* * * decedent's taxable income should have been computed in the same way it would have been had he been alive and regularly making his returns upon the accrual basis."

With regard to the erroneous reasoning of the Board of Tax Appeals in affirming the action of the Commissioner, Judge Maris in the court below said:

> "We think the Board fell into error in failing to treat the partnership as a tax computing unit separate from its member, Enright. That the Revenue

> Act requires that a partnership be so treated is clear from its provisions for the computing of partnership income and the filing of partnership returns and has been recognized by the courts. Thus a partnership may make its return for a taxable year different from that of its members, and it may likewise make its return upon an accounting basis different from that used by the individual partners."

That the Circuit Court of Appeals correctly construed Section 42 as amended, is evident from the arrangement of the Revenue Act. Section 4 provides that the general provisions of the Act are subject to the special provisions in the Act with respect to certain classes of taxpayers.

Section 42, relied upon by the Commissioner in making the deficiency assessment in this case, is included in the title "General Provisions."

Sections 181 to 188 inclusive, apply to one of the special classes of taxpayers referred to by Section 4, to-wit, Partnerships.

So that, as to a partnership as such, its method of accounting, its computation of the distributive shares of its partners, etc., the provisions of Sections 181 to 188 are controlling and Section 42 has no application.

Accordingly, where the partnership is on a cash basis, a deceased partner's executor, under Section 182, is bound to report only his distributive share of the cash basis net income of the partnership at his death. He is not bound to report the deceased partner's share of all the partnership accrued income on the theory that it is cash on hand available for distribution. For stronger reasons, the executor is not required to report as income accrued, the deceased partner's share of that which is not even accrued income to the partnership, as the Commissioner determined in this case.

Section 182 has for years been a special section of the Revenue Acts applying to a special type of gross income, while Section 42 is a general provision of the Tax Act of 1934, applicable to all types of income, not otherwise specifically provided for in the Act. It is submitted that inasmuch as Congress did not alter or amend Section 182 at the time of the enactment of the 1934 Amendment to Section 42, the latter section as amended has no application to this special type of gross income, to-wit, the *distributive share* of a partner in the income of the partnership.

The purpose of Section 42 was merely to effect the change in the individual method of accounting where the taxpayer died during the taxable year. It was not intended to affect potential income which the taxpayer would have had no right to receive even if he had employed the accrual method of accounting during his lifetime.

What constitutes accrued income to a taxpayer at his death, who during his lifetime had regularly employed the cash receipts and disbursements method of accounting, is controlled by what would have constituted his income had he lived and used the accrual method of accounting in keeping his books.

Fehrman vs. *Commissioner*, 38 B. T. A. (No. 7) (1938).

In *Guaranty Trust Co.* vs. *Commissioner*, 303 U. S. 493, Mr. Justice Stone said:

> "Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it, nor the duration of his investments which have finally resulted in profit. Lucas *vs.* Alexander, 279 U. S. 573.

"The Revenue Acts have consistently adhered to that policy in taxing the income of a partner. Since the partner is entitled to profits only upon a partnership accounting at the end of the accounting period, his profits become subject to income tax when and as they are thus ascertained."

It is contended in the petition before this court that Congress, by Section 42 of the Revenue Act, intended to tax to decedent all income earned during his lifetime.

There is nothing in the 1934 amendment to Section 42 of the Revenue Act, or in the report of the Ways and Means Committee of the House, or the report of the Finance Committee of the Senate indicating any such intention.

II.

The decision of the Circuit Court of Appeals for the Second Circuit, affirming the decision of the Board of Tax Appeals in *Pfaff, et al., Executors of Wallace* v. *Commissioner,* is clearly wrong.

The decision, in *Pfaff* vs. *Commissioner* (*supra*) cited by the Commissioner as in conflict with the decision of the court below, is reported at 113 Fed. (2d) 114. A petition for a writ of certiorari to review the judgment in the *Pfaff* case has been filed in this court and is docketed as No. 479.

The Circuit Court of Appeals for the Second Circuit in deciding the *Pfaff* case fell into error in failing to treat the partnership as a tax computing unit separate from its member Wallace; and also in treating as income accrued services partly rendered by the partnership which had not even been billed. Consequently, the income had not even accrued to the partnership.

Conclusion.

It is respectfully submitted that the case at bar was correctly decided below, and that the writ of certiorari as prayed for herein should be denied.

Respectfully submitted,

JAMES D. CARPENTER, JR.,
Of Counsel with Respondents.

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FILED
FEB 12 1941
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 436.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

ESTATE OF JOHN M. ENRIGHT, deceased, JAMES G. ENRIGHT, EMMA E. NEILSON and MILDRED L. ENRIGHT, Executors,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENTS.

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Opinion Below.

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Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 17, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

(1) Whether Section 42 of the Revenue Act of 1934 requires that there be included as income in the last income tax return of a deceased partner his share of the estimated value of the gross assets of a partnership, consisting of legal services rendered, the value of which is neither known, or due and payable to the partnership, both the partnership and the deceased partner being on the cash basis.

(2) Whether the words "income accrued", as used in Section 42 of the Revenue Act of 1934, include in their meaning a deceased partner's interest in the gross assets of a law partnership, where such assets consist of legal services partly rendered and would not have constituted an accrual to the partnership even had it maintained its books of account on an accrual basis.

Statutes and Regulations Involved.

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pages 31-35.

Statement of Facts.

The facts of the case established by stipulation (R. 25-33) and testimony (R. 22-25) may be summarized as follows:

John M. Enright (hereinafter referred to as the decedent) died testate, a resident of Freehold, Monmouth County, New Jersey, on November 19, 1934.

The decedent, up to the time of his death, was the senior partner of the law firm of McDermott, Enright & Carpenter,

engaged in the practice of law in Jersey City, New Jersey. The books of account of this partnership were kept upon a calendar year cash receipts and disbursements method of accounting (R. 26). The decedent reported his income on the cash receipts and disbursements method of accounting.

The interest of decedent at the date of death in the cash on hand in the firm bank accounts was $4,143.81, which sum was included as income accrued to the date of death in the income tax return filed by the executors (R. 28).

The other assets in the firm consisted of accounts receivable considered collectible, decedent's interest being $2,055.55, and "over 400 pending cases in which work had been done and on which additional work had to be done before the amount of fees to be charged could be determined and the cases billed to clients" (R. 28).

After decedent's death, the senior surviving partner, for estate and inheritance tax purposes, made an appraisal of all the cases in the office at the date of death and determined that the probable amount that had been earned to the date of death, including the probable realizable cash disbursements, aggregated $118,422.51. Decedent's interest at 34½ per cent. thereof was $40,855.77. The aggregate of decedent's interest in accounts receivable of $2,055.55, plus said amount of $40,855.77, was $42,911.32, which was reported in the Federal estate tax return and in the New Jersey transfer inheritance tax return as decedent's interest in the business of the firm as of the date of death (R. 28).

The firm had nine matters pending at the date of death in which work was being done on a fixed fee basis and Mr. Enright's share of the amounts earned in said matters to the date of death was $1,024.89 (which was included in the sum of $42,911.32). In none of such matters were the

fees payable at the date of death but they were payable on a per month or per annum basis at future dates. Practically all other pending matters in the partnership were being handled on the basis of the firm being paid a reasonable fee for the work done, taking into account the amounts involved, the results accomplished for clients, and the time and effort devoted to the cases. A few cases were being handled for clients on a contingent fee basis in which the amount of fee ultimately realizable depended solely upon success. The amounts payable to the firm upon the completion of the business also depended upon the client being satisfied with the amount of fee charged (R. 28-29).

It was agreed between the executors and the senior surviving partner that the estimate of decedent's interest in the firm business of $42,911.32 was to be used for the purposes of the Federal and State estate tax returns and that the amount ultimately realizable for the estate of deceased as Enright's earned proportion at the date of death in the unfinished business of the firm might ultimately be greater or less than the estimate (R. 29).

The partnership, decedent's estate, and all the individual members of the firm filed their income tax returns on the cash basis (R. 29).

Between the date of death and February 2, 1939, the successor firm paid to petitioners in liquidation of decedent's earned proportion of the receipts from business that was in the office at the date of death, $45,965.15 (R. 30).

In the partnership returns filed by the firm (Form 1065) for 1934, 1935 and 1936, the amount paid the Enright Estate was shown in each year as to amount as "capital to estate in liquidation" (R. 31).

As each case was closed and the fee paid, Mr. Carpenter re-examined the charge sheets to determine whether

the amount originally estimated as decedent's interest therein to the date of death was correctly stated. In some cases the amount estimated was increased, whereas in other cases it was decreased. Some moneys were collected by the firm which were not shown on the books at the date of death and the executors were paid decedent's interest therein. The liquidation has not yet been completed (R. 31).

It was further stipulated that the successor firm did not buy decedent's interest but paid his estate, after it was received, his percentage of the outstanding accounts collected and his earned proportion of the unfinished business after the fees were collected by the firm. His executors from time to time were paid exactly what decedent was entitled to on strict liquidation with no deductions from said amount (R. 32-33).

Mr. Carpenter, the senior surviving member of the firm, testified that he started to appraise all matters in the office the day Mr. Enright died but did not finish until nearly a year later. This appraisal was made for the purpose of Federal estate tax and the State of New Jersey transfer inheritance tax on the estate. "We had to do this in order to know what his gross estate was on which to pay such taxes" (R. 23).

Mr. Carpenter testified:

> "I know from my knowledge of the business in the office and how it was handled and what has happened that had we not continued the business with considerable success and good fortune, we would not have realized the amount we have ultimately realized, nor could we have realized the amount I estimated. Some of the firm business was the representation of receivers and trustees, executors and administrators, and allowances in our State in such matters are subject to the approval of the courts, in fact, they are

made by the courts. I am perfectly confident in those cases had the successor firm not been formed to carry on the business and had we sent out bills or applied for allowances to date, we never could have realized and the court would not have ordered any such per diem rate as we ultimately received, and I am confident that hard work and perhaps some good fortune increased the amount anticipated. In many cases it indicates that we received a per diem rate over what I had originally estimated.

"Mr. Enright and all his partners were in 1934 and always have been on a cash basis and none of them has ever been on an accrual basis. So is the firm" (R. 23).

The Board of Tax Appeals held that decedent's share of the accounts receivable and estimated unfinished business of the partnership should be included in his gross income for that period (R. 15). On appeal the Circuit Court of Appeals for the Third Circuit reversed the decision of the Board (R. 34).

POINT I.

(Answering Petitioner's Argument No. 1 at pages 10 to 19.)

The decision of the Circuit Court of Appeals for the Third Circuit holding that the established rules for computing and taxing partnership income are not affected by the provisions of Section 42, is sound.

The Government contends that the income computing method of the partnership is not determinative of "amounts accrued up to the date of his death" of a deceased partner

in the income of the partnership. The Government also contends that the estimated value of services rendered by decedent up to the date of his death is income accrued within the meaning of Section 42 of the Revenue Act of 1934 and that it is immaterial that the estimated value of services rendered by decedent should ever have been distributable to him during his lifetime.

In support of its contentions, *Guaranty Trust Co.* vs. *Commissioner,* 303 U. S. 493, and *Bull* vs. *United States,* 295 U. S. 247, are cited as authorities. Respondents submit that neither decision supports the position of the Government. The Government, on page 15 of its brief, concedes that in each of these cases the income which was taxed to the decedent was actually in the treasury of the partnership at the date of death.

Guaranty Trust Co. vs. *Commissioner, supra,* involved construction of Section 182(a) of the Revenue Act of 1932 respecting the amount to be included in the last return of a deceased partner, where the taxable year of the partner differed from that of the partnership. This Court held that at dissolution the *partnership* income which had been realized to the date of death under *its* method of accounting, became distributable; and that decedent's share of such income was includible in his last return. This Court in construing the provisions of the statute involved stated (p. 500):

> "* * * The object is * * * to make certain that 'the amount so included' in a partner's taxable income 'shall be based upon the income of the partnership' distributable during the partner's taxable year. * * *"

In the *Guaranty Trust* case this Court recognized that the taxable income of a deceased partner in the income of

the partnership is his distributable share of the *partnership income* determined according to *its* income computing method.

> "By these provisions" (Sections 182 to 188) "the taxable income of a partner is limited to that share of the partnership earnings to which he becomes entitled within his taxable year, but it includes all the distributive share of the partnership income which accrues to him in that year even though earned in an accounting period not wholly within the year, and though his return, as in the case of decedent, is on the cash receipts and disbursements basis" (p. 498).

In *Bull* vs. *United States, supra,* this Court held that the item of $24,124.20 was decedent's share of the income of the partnership according to its method of accounting, and should be included in decedent's gross income to the date of death. In that case this Court was concerned solely with profits *actually received by the firm* prior to the partner's death. Since all the income was received by the firm prior to decedent's death this Court did not use the word "earned" meticulously, because there was no question of accrual presented to the Court.

The decisions of this Court in *Guaranty Trust Co.* vs. *Commissioner, supra,* and in *Bull* vs. *United States, supra,* duly recognize that the distributive share of a deceased partner is to be computed according to the income computing method of the firm and in compliance with the partnership agreement. The contention of the Government that the distributive share of a deceased partner is to be computed irrespective of the method of accounting used by the partnership, is not supported by either of the above decisions of this Court.

A.

By express provision in the 1934 Act, Section 42 has no application to the method of determining a partner's distributive share of the partnership income.

That the Circuit Court of Appeals correctly construed Section 42, as amended, is evident from the arrangement of the Revenue Act itself.

> Section 4 provides that the application of the General Provisions is "subject to the exceptions and additional provisions" of the Supplemental Provisions, therein enumerated.
>
> Section 42 is a General Provision of the Act applying to all taxpayers not otherwise specifically provided for elsewhere in the said Act.
>
> Sections 181, 182, 183 and 187 on the other hand, are Supplemental Provisions of the Act applying to a special class of taxpayers, to wit:—Partnerships.

So that, as to a partnership as such, its method of accounting, its computation of the distributive shares of its partners, etc., the provisions of Sections 181 to 188 are controlling and Section 42 has no application.

This view is supported by Article 42-3 of Regulations 86 of the United States Treasury Department, which states:

> "* * * As to the distributive share of the profits of a partner in a partnership, see section 188 * * *." [Sec. 188 was a printer's error. It should have been 182 and was corrected in regulations printed in 1935.]

Accordingly, where the partnership is on a cash basis, a deceased partner's executor under Section 182 is bound

to report only his distributive share of the cash basis net income of the partnership at death. He is not bound to report the deceased partner's share of all the partnership accrued income on the theory that it is cash on hand available for distribution. For stronger reasons, the executor is not required to report as income accrued, the deceased partner's share of the total assets of the firm, as the Commissioner determined in this case.

Moreover, Section 42 is found in Part IV of Subtitle B of the Revenue Act entitled "Accounting Periods and Methods of Accounting", while Section 182 is in Supplement F devoted to "Tax of Partners". Therefore, the only possible conclusion that can be drawn is that Section 42 is devoted to accounting problems, while Section 182 lays down the law as to the method of determining tax on the distributive share of a partner in a partnership.

In addition, there is no provision anywhere in the 1934 Act requiring a compulsory change by a partnership of its method of accounting, in the event of the death of a partner.

When Congress in 1934 enacted Section 42, it was fully cognizant of Section 182, which originated in the Revenue Act of 1921, and yet made no attempt to alter or amend it. On the contrary, by Section 4, it made Section 182 supreme.

Thus, since 1921, a *partner* who used the cash receipts and disbursements method of accounting in keeping his individual books has been required by Section 182 to report as an item of gross income, his *distributive share* of the net income of the partnership, in the same manner as though he were on an accrual basis. And since 1921 where such a *partner* died during the taxable year, his executor or administrator was required by Section 182 to report as an item

of gross income the deceased partner's *distributive share* of the income of the *partnership* computed according to *its* method of accounting, in the same manner as though said partner were on an accrual basis.

Nichols vs. *United States*, 64 Ct. Cl. 241; cert. den. 277 U. S. 584;

City Bank, etc. vs. *Commissioner*, 29 B. T. A. 190;

Hall, et al., Executors vs. *Commissioner*, 24 B. T. A. 1;

Goldman vs. *Commissioner*, 15 B. T. A. 1341.

Both Section 182 and Section 42 have for their sole purpose the prevention of income escaping taxation which would ordinarily escape where the taxpayer uses the cash receipts and disbursements method of accounting. Section 42 seeks to accomplish with respect to the income of a decedent who used the cash receipts and disbursements method of accounting, exactly that which has been accomplished since 1921 by Section 182 with respect to the *distributive share* of a partner in the income of a partnership, whether the partner is living or dead. In the case of the death of a taxpayer, who had been reporting on a cash basis, Section 42 makes it mandatory that the method of accounting be changed to an accrual basis. In the case of a living or dead partner who uses the cash receipts and disbursements method of accounting, Section 182 makes it mandatory that with respect to a special item of gross income, to wit;—his *distributive share* of the income of the partnership—he use the accrual method of accounting.

Section 182 has for years been a special section of the Revenue Acts applying to a special type of gross income, while Section 42 is a general provision of the Revenue Act

of 1934, applicable to all types of income, not otherwise specifically provided for in the Act. It is submitted that inasmuch as Congress did not alter or amend Section 182 at the time of the enactment of the 1934 Amendment to Section 42, the latter section as amended has no application to this special type of gross income, to wit;—the *distributive share* of a partner in the income of the partnership.

B.

Partnerships have always been regarded by the Income Tax Laws as distinct income computing entities.

In the Revenue Act of 1934, as in earlier and later Revenue Acts, partnership income is computed and taxed in accordance with well established rules. A partnership is treated as a tax computing unit separate and distinct from its members. *Johnston* vs. *Commissioner,* 86 Fed. (2d) 732; cert. denied 301 U. S. 683. That a partnership is so treated is clear from the provisions of the Revenue Act itself providing for the computation of partnership income and the filing of partnership returns. *Guaranty Trust Co.* vs. *Commissioner, supra. Archbald* vs. *Commissioner,* 27 B. T. A. 837, affirmed 70 Fed. (2d) 720; cert. denied 293 U. S. 594.

In *Archbald* vs. *Commissioner, supra,* the Board of Tax Appeals recognized that a partnership is a separate and distinct income computing entity from its members, when it stated:

> "* * * The income of partnerships has been required to be computed *quoad* the partnership before ascertaining the taxable distributive shares, and this partnership income is so far distinct from that of the individual partners that it takes its own fiscal year

whenever that year is different from that of the partner, L. O. 816, 1 C. B. (1919) 168; L. O. 972, 2 C. B. (1920) 163; and this, even when it results in a different credit for an individual in partnership from that of an individual sole proprietor. Shearer *v.* Burnet, 285 U. S. 228; Charles Colip, 5 B. T. A. 123. The fact that the tax imposed upon corporations and associations carried an express exception —'not including partnerships'— implies a recognition of the unity of partnership; and the exclusion is only applicable to 'ordinary partnerships', Burk-Waggoner Oil Ass'n *v.* Hopkins, 269 U. S. 110.

"It is clear, therefore, that a doctrinaire assertion that a partnership is not an entity affords no key to the determination. Congress has not taxed partnerships directly; but, apart from that, there is no reason to think that their existence was ignored or that for other purposes under the statute their legal character was not to be fully accepted. W. J. Burns, 12 B. T. A. 1209; Henry W. Healy, 18 B. T. A. 27, 32" (pp. 840-841).

In *Johnston* vs. *Commissioner, supra,* the Circuit Court of Appeals for the Second Circuit stated:

"(1-3) • • • Though a partnership is not a taxpayer (section 181 of the 1932 Revenue Act (26 U. S. C. A., sec. 181 and note)) and each partner is taxed on his distributive share of partnership income (section 182, 47 Stat. 222 (see 26 U. S. C. A., sec. 182 and note)), the partnership is a tax computing unit whose income is to be calculated in the same manner and on the same basis as that of an individual, with the exception that no deductions for charitable contributions are allowable (section 183 of the act (26 U. S. C. A., sec. 183 and note)). See Earle *v.* Commissioner (C. C. A.) 38 F. (2d) 965 • • •."

See also

Walbridge vs. *Helvering,* 70 Fed. (2d) 683;
Finucane vs. *United States,* 21 Fed. Supp. 122;
Klingenstein vs. *United States,* 18 Fed. Supp. 1015.

The recent decision of this Court in *Neuberger* vs. *Commissioner,* No. 5, this Term, is not in point because it involved merely the construction of Section 23(r)(1) of the Revenue Act of 1932 to determine whether the loss of an individual partner could be offset against a partnership gain. The case did not involve the question of the taxability of a partner's *distributive share* of partnership income.

POINT II.

(Answering Petitioner's Argument No. 2, pages 19 to 28.)

It has been firmly established by this Court that the provisions of the Revenue Act are not to be extended by implication beyond the clear import of the language used.

The Government contends that the purpose of Congress in enacting Section 42 was to cover all income earned during the lifetime of a decedent, and that unless all income earned by a decedent during his lifetime is taxed in his last return as income accrued, it escapes taxation.

This contention of the Government is based on the supposition that when Congress employed the word "accrued" in the 1934 amendment to Section 42, Congress intended to

tax all the "earned" income of a decedent up to the date of death.

Section 48(c) of the 1934 Revenue Act completely nullifies the position taken by the Government. That section provides that, as used in Part IV, the term "paid or accrued"

> "* * * shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part."

Article 41-2 of Regulation 86 of the United States Treasury Department states that:

> "Applied standard methods of accounting will ordinarily be regarded as clearly reflecting income."

Since the word "accrued" is, under Section 48(c) to be construed according to a method of accounting, the only logical conclusion is that Congress intended by the enactment of the 1934 amendment to Section 42 to automatically effect a change in the method of accounting of a deceased taxpayer from a cash basis to the accrual basis.

The Government's contention that its contention should be approved to prevent the loss of revenue, is unsound. The argument advanced is that unless the appraised value of decedent's services to the date of death are taxed as income at the time of his death, it cannot be taxed later and the Government will suffer a loss of revenue. The same argument can be applied to increment in the value of any property owned by a decedent at the time of his death. Such increment could not be taxed as accrued income unless the property had been sold prior to the date of death. The mere desire to obtain revenue cannot justify the inclusion in the

income of a decedent of any unrealized increment, under the Sixteenth Amendment. Likewise, the value of services which have not ripened into income at the date of death cannot be classed as income under the said Amendment.

Moreover the contention of the Government seeks to extend, by implication, the provisions of Section 42, as amended. This Court has repeatedly refused so to do.

In *Gould* vs. *Gould,* 245 U. S. 151, this Court held (p. 153):

> "In the interpretation of statutes levying taxes, it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen. United States *v.* Wigglesworth, 2 Story, 369, Fed. Cas. No. 16,690; American Net & Twine Co. *v.* Worthington, 141 U. S. 468, 474, 35 L. ed. 821, 824, 12 Sup. Ct. Rep. 55; Benziger *v.* United States, 192 U. S. 38, 55, 48 L. ed. 331, 338, 24 Sup. Ct. Rep. 189."

See also *United States* vs. *Field,* 255 U. S. 257, 65 L. Ed., 617, and *Smietanka* vs. *First Trust & Savings Bank,* 257 U. S. 602, 66 L. Ed. 391.

A.

Under Section 42 decedent's executors are required to report as income only that which decedent himself would have had to report had he lived and used the accrual method of accounting.

It will be observed that under the general rule of Section 41, a taxpayer is to compute his net income "in accordance with the method of accounting" he regularly employs in keeping his books.

Section 42 deals exclusively with a taxpayer who uses the cash receipts and disbursements method of accounting and provides that he shall report all items of gross income in the taxable year in which they were actually received. The 1934 amendment to Section 42 contains the additional provision that where such a taxpayer dies during the taxable year, his executor or administrator shall report his income in accordance with the accrual method of accounting. This amendment was aimed solely at affecting a change in the taxpayer's individual method of accounting where the taxpayer died during the taxable year, in order to prevent income escaping taxation which would not otherwise escape had the taxpayer regularly employed the accrual method of accounting.

What constitutes accrued income to a taxpayer at his death, who during his lifetime had regularly employed the cash receipts and disbursements method of accounting, is controlled by what would have constituted his income had he lived and used the accrued method of accounting in keeping his books.

It will be further observed that Section 182, in providing that a partner shall report his *distributive share* in the income of the partnership whether distributed to him or not, requires a partner who employs the cash receipts and disbursements method of accounting in keeping his books, to use the accrual method of accounting in reporting his *distributive share* of the income of the partnership.

Accordingly, where both a partner and the partnership used the cash receipts and disbursements method of accounting, the partner is required to report as income his *distributive share* of the moneys on hand in the partnership at the close of the taxable year, *whether distributed to him*

or not. And where the partner is on a cash basis and the partnership employs the accrual method of accounting, the partner is required to report his *distributive share* of the income of the partnership computed according to *its* method of accounting *whether distributed to him or not.*

Therefore, had John M. Enright lived until the end of the 1934 taxable year and employed the accrual method of accounting, he would have been required to report as income from the law partnership of McDermott, Enright & Carpenter for that year, his *distributive share* of the cash in the partnership treasury, whether distributed to him or not (the partnership having employed the cash receipts and disbursements method of accounting).

Enright's death did not place upon his executors any greater obligation than to report as income that which he himself would have been required to report had he lived and employed the accrual method of accounting during his lifetime.

POINT III.

(Answering Petitioner's Argument No. 3, pages 28 to 34.)

Where the partnership and decedent were both on the cash basis, the only accruable item in the partnership, taxable under Section 42, was decedent's share of cash in the partnership treasury.

The Government contends that inasmuch as the evidence does not show the situation with regard to the accounts receivable and the unfinished business of the partnership in sufficient detail, the total amount of decedent's

share of said items was accrued income under Section 42. The Government also contends that the criteria for determining whether an item has "accrued" under Section 42 is not as rigid as that laid down in *Fehrman* vs. *Commissioner,* 38 B. T. A., 37, and cannot have any precise meaning apart from the circumstances of a given taxpayer's case.

The Government's position is untenable. Since the partnership kept its books on the calendar year cash receipts and disbursements basis, and since the income of the partnership computed by such method of accounting, became taxable to the partners at the time it became distributable, regardless of the basis on which the individual income of the partner was computed, any change in a partner's basis, whether voluntary or under Section 42, cannot affect either the amount of the partnership income or the time when the partner's share thereof becomes taxable to him.

A.

Accounts receivable by the firm are not income accrued.

Under Section 182 of the Revenue Act a partner is taxed on his "distributive share" of the partnership net income, whether distributed or not.

Section 183 provides that the net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual.

It is to be observed that Sections 42 and 43 of the Act of 1934 attempt to make the accrual system *exclusive* and *mandatory* as to an individual in the event of death.

What items therefore are the subject of "accrual" as used in the statute?

> "* * * Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it nor the duration of his investments which have finally resulted in profit. Lucas *v.* Alexander, 279 U. S. 573."
>
> *Guaranty Trust Company* vs. *Commissioner*, 303 U. S. 493, 498.

> "* * * When the right to receive an amount becomes fixed, the right accrues * * *."
>
> *Spring City Foundry Company* vs. *Commissioner*, 292 U. S. 182, 184-5.

"It is of course true, as the Board points out, that under the accrual method of accounting employed by petitioner, items must be accrued as income when the events occur to fix the amounts due and determine liability to pay. United States *v.* Anderson, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347. Generally speaking, however, the income tax law is concerned, and its administration should deal only, with realized losses, and realized gains. Lucas *v.* American Code Co., 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A. L. R. 1010. The taxpayer therefore, is under no obligation to pay a tax on income he might never receive. North American Oil Consolidated *v.* Burnet, 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197. A strained construction in administrative efforts to accrue income should be avoided.

"Of the many cases supporting this view, Com'r *v.* Cleveland Trinidad Paving Co., 6 Cir., 62 F. 2nd 85; McPherson *v.* Helvering, 62 App. D. C. 325, 67 F. 2d 749; Burnet *v.* Logan, 283 U. S. 404, 51 S. Ct. 550, 75 L. Ed. 1143; Woods *v.* Lewellyn, 3 Cir., 252 F. 106, may be cited."

Commissioner of Internal Revenue v. *Edwards Drilling Company*, 95 Fed. (2d) 719, 720.

"From the above expressions, it is apparent that the general definition of 'accrued' is limited when taken in connection with income returns. We may conclude that income has not accrued to a taxpayer until there arises to him a fixed or unconditional right to receive it."

H. Liebes & Co. v. *Commissioner of Internal Revenue*, 90 Fed. (2d) 932, 937.

"* * * In order to be accruable in the taxable year for which the return is made, a valid obligation to pay must have existed in that year, which is enforceable on the date when the obligation is due. When, however, the obligation to pay is contingent upon the happening of some future event, there is no certainty that it will be paid or will accrue. In such event, no obligation accrues from a fixed or determinable source and no duty arises or exists in the taxable year which can be accounted for as income under any system of accounting. * * *"

Helvering v. *Russian Finance & Construction Corporation*, 77 Fed. (2d) 324.

See also *United States* vs. *Amalgamated Sugar Company*, 72 Fed. (2) 755, 759; *Elmhirst* vs. *Duggan*, 14 Fed. Supp. 782, 783; *Schoelkopf Aniline & Chemical Works* vs. *United States*, 3 Fed. Supp. 417, 421-2.

B.

Services rendered and not completed or billed by the partnership are not "income accrued" to decedent.

Legal services rendered by a partnership on a *quantum meruit* basis and partly performed cannot possibly be con-

strued as "income accrued" to a partner, living or dead, of a partnership that employs the cash receipts and disbursements method of accounting in computing its income.

Some services were rendered on a fixed charge basis, payable per month or per annum at later dates than date of death. The total amount of such fees earned to the date of death was $1,024.89, which amount was included in the estimate of $42,911.32 (R. 28-29).

The evidence here is that in 55 cases the per diem rate originally estimated was increased; in 22 cases decreased as the final termination of the matters warranted, with the client's approval (R. 31).

In many cases that were being handled by the partnership the clients were receivers, trustees, executors and administrators, and in such cases the fees payable to lawyers in New Jersey are fixed by the Court upon the termination of the matter (R. 24).

Upon liquidation the obligation of the surviving partners, as trustees in liquidation, was (a) to reduce the assets to cash, (b) to pay debts, (c) to distribute the remainder to the surviving partners and the estate of the deceased partner according to the interest of each at the moment of dissolution.

Molineau vs. *Reynolds,* 54 N. J. Eq. 559; 47 Corpus Juris, p. 1042.

We urge that as a matter of law the interest of decedent in his partnership (beyond his share of the distributable cash in the treasury) was not income within the meaning of the 16th Amendment.

Eisner v. *Macomber,* 252 U. S. 189.

C.

Even if the partnership used the accrual method of accounting, it would be improper to include as an item of income the appraised value of the work in process.

A law partnership, unlike commercial partnerships, sells only the services of its members.

Assuming a law partnership that employs the accrual method of accounting in keeping its books, the only item which could properly be accrued on its books would be accounts receivable which are due and payable. And the only accounts receivable which are due and payable to a law partnership are those wherein the services involved are completed and a bill rendered to the client.

Work in process of a law partnership consists of the examination of statutes and authorities, preparation of pleadings, preparation for trials, preparing agreements, indentures, searching titles, writing briefs, and a host of other matters which it is not necessary to attempt to specify.

Ordinarily, until the lawyer's work is completed he cannot expect payment, unless it be for the occasional client who will pay a retainer; or in the unusual situation of a litigation lasting years where payments on account are made as the work progresses.

In *Woodbury* vs. *Andrew Jergens Co.*, 37 Fed. (2d) 749, affirmed 61 Fed. (2d) 736, cert. denied 289 U. S. 740, District Judge Woolsey in discussing the measure of the value of a lawyer's services, stated (p. 750):

> "The value of a lawyer's services is not measured by time or labor merely. The practice of law is an art in which success depends as much as in any other art on the application of imagination—and

> sometimes inspiration—to the subject-matter. The exercise of these faculties may occur at any stage in a case, though their influence on the court of the proceeding may not be established till its outcome."

See also *Shattuck, et al.* vs. *Pennsylvania R. Co.*, 48 Fed. (2d) 346.

It is firmly established that agreements entered into by lawyers with clients are in the nature of unilateral contracts under which the client promises to pay the agreed compensation when and if all the services contracted for have been fully performed.

In A. R. R. 702, I-1 Cumulative Bulletin 1922, page 47, a law partnership charged clients on its books for incomplete legal services rendered. The opinion stated:

> "There is no fixed standard for the determination of the value of legal services, the mere rendition of such services not fixing their value."

In *S. Naitone & Co. Inc.* vs. *Commissioner*, 32 F. (2d) 949, 952, the court held that in a unilateral or conditional contract, the amount may be said to be accrued when it is definitely received.

(A. R. R. 6158, Cumulative Bulletin 1924, p. 75.)

Work in process of a law partnership, because of its peculiar nature, cannot be considered as income accrued even where the partnership employs the accrual method of accounting in keeping its books.

POINT IV.

The purpose of Section 42, Revenue Act of 1934, was to tax what was in fact income; not to attempt to create income and then tax it.

The partnership agreement provides that the earnings of the firm distributable to the partners shall be determined annually on the basis of cash receipts and disbursements. "All receipts subsequent to the date hereof shall be considered as income subject to this agreement, regardless of when earned" (R. 26).

After the death Federal estate tax law (U. S. Code, Title 26, Sections 410 to 427) required the executors to make a return, under oath, setting forth the value of the gross estate of the decedent, the value of the net estate, as defined in Section 411, and the tax paid or payable.

The New Jersey transfer inheritance tax act (P. L., 1934, Chap. 243) contained similar provisions.

To comply with these laws, the senior surviving partner, pursuant to paragraph 5 of the partnership agreement (R. 26), and paragraph eight of decedent's will (R. 27), made an appraisal of the value of decedent's interest in the partnership. The appraised amount was $42,911.32 (R. 28).

The Commissioner and the Board below determined that this sum was income accrued to decedent at the date of death.

An examination of the report of the Ways and Means Committee of the House and the report of the Finance Committee of the Senate on Sections 42 and 43, clearly shows that it is not the purpose of Section 42 to accrue partnership income in computing the income of an individual part-

ner. Only the income of deceased individuals is to be accrued.

In *Fehrman* vs. *Commissioner*, 38 B. T. A. 37 (No. 7) (1938), the general effect of Sections 42 and 43 was carefully considered in the light of the purposes of their enactment, as indicated by the Reports of the Finance Committee of the Senate, and of the Committee on Ways and Means of the House of Representatives. The Board's conclusion was as follows:

> "It is obvious from the language of the act and the legislative intent as disclosed by the committee reports quoted above that the purpose of Congress was to treat the income of a decedent as though *he* were on an accrual basis even though *he* was actually on a cash basis and kept his books on a cash basis, and that the phrase, 'amounts accrued up to the date of his death' means those amounts which would be properly included in a decedent's income if *he* were on an accrual basis as distinguished from a cash basis." (Emphasis added.)

The true purpose of Section 42 was to tax items of income to the taxpayer which under earlier decisions were escaping income taxes prior to 1934. Such were:

Interest. Interest accrued at time of decedent's death is part of corpus and not taxable income. *William K. Vanderbilt*, 11 B. T. A. 291; *Frank H. Clark*, 12 B. T. A. 425. Interest owed before but paid after decedent's death is corpus. *Mellie Esperson Stewart*, 18 B. T. A. 1010.

Salaries. Salary due decedent at date of his death is a capital asset and part of corpus of estate; no income in-

volved if amount received no greater than amount due at death. *Frank H. Clark,* 12 B. T. A. 425.

Rents. Rent owed but not due and payable at decedent's death constitutes part of corpus of estate, and when collected does not become income. *E. S. Heller,* 10 B. T. A., page 53.

Dividends. Article 115-1 requires that a dividend shall be included in gross income when the cash or other property is unqualifiedly made subject to the demands of the stockholder. [Dividends declared prior to the death of a taxpayer which are not payable until after his death constitute accrued income taxable to decedent within the meaning of Section 42. I. T. 2822 C. B. Dec. 1934, p. 54.]

In the case at bar the executors included in decedent's return as income accrued to the date of death decedent's share of the money in the treasury of his partnership (R. 28). The Commissioner assessed a deficiency for omitted accrued interest on bonds, held by decedent individually. The executors promptly paid the resulting tax on this omission (R. 28). Such items were within the true meaning of Section 42.

When, however, the Commissioner construed Section 42 as including within its meaning decedent's entire interest in the total value of the partnership assets as estimated for purposes of Federal estate taxes and transfer inheritance taxes, he erred in that (1) his ruling was contrary to the terms of the Act; (2) then Section 42 became void as an attempt to create as income to the decedent that which was not in fact income to him, in order to tax it.

POINT V.

A broader construction of Section 42 than that made by the Circuit Court of Appeals below would result in the section being unconstitutional and null and void.

The Government seeks to have this Court, by construction, extend the provisions of Section 42 so as to include in gross income, items which Congress has not directed to be included, and which Congress would have no power to tax under the Sixteenth Amendment.

Section 42 as construed by the Board of Tax Appeals would tax as income that which is not income in fact.

Income is taxable only to those persons to whom it is income.

> *Saenger* vs. *Commissioner*, 69 Fed. (2d) 631;
> *Hartley* vs. *Commissioner*, 72 Fed. (2d) 352;
> *Hoeper* vs. *Tax Commissioner*, 284 U. S. 206, 76 L. Ed. 248, 251.

Section 42 as construed by the Board below would be in conflict with the Fifth Amendment of the Constitution and be null and void for the following reasons:

(a) That said section attempts to tax to a deceased partner his share of the estimated value of services performed by his partnership as income accrued to the date of his death, yet income taxes as to all other members of the partnership are assessed as of the date when the partnership receives and distributes the proceeds of services rendered; and

(b) said section is arbitrary, harsh and confiscatory in that, where members of a partnership are all on a cash basis and one dies it makes the fact of death create the entire interest in the partnership of the deceased partner as taxable income, although the interest of the surviving partner or partners is not taxable income to them until the partnership assets are liquidated.

The record shows that while the Estate was taxed on Enright's entire interest in the partnership as income accrued to him in 1934, the other partners were taxed on the income *as it was received* in liquidation over a six year period.

The effect is that Enright's entire interest in the partnership being added in one lump to his 1934 gross income, raises his status in the surtax bracket and the surtaxes are consequently far greater than they would have been had he lived and paid taxes thereon during the years when the income was in fact distributable.

We realize that Courts will not unnecessarily hold an Act of Congress unconstitutional, but if Section 42 was correctly construed by the Board of Tax Appeals, then it must fall as violating the Constitution.

Conclusion.

(1) Decedent's interest in the pending professional undertakings of his partnership was not income within the meaning of the 16th Amendment.

(2) The estate having reported in the estate tax return as required by law, decedent's interest in his law firm and having paid the estate tax thereon, the same amount under

the facts of this case cannot be subjected to an income tax, unless required by express words of the statute.

United States vs. *Supplee-Biddle Hardware Co.*, 265 U. S. 189.

(3) Section 182, Revenue Act 1934, controls the method of accounting for a deceased partner's distributive share of the income of the partnership, and Section 42 has no application.

(4) Decedent's interest in his partnership was in fact capital, not income.

Lillian O. Fehrman, 38 B. T. A. 37;
Bull vs. *United States*, 295 U. S. 247;
City Bank, Ex'r. vs. *Commissioner*, 29 B. T. A. 190.

The decision of the Circuit Court of Appeals for the Third Circuit should be affirmed.

JAMES D. CARPENTER, JR.,
Counsel for Respondents.

APPENDIX.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1934, C. 277, 48 Stat. 680:

SUBTITLE A—INTRODUCTORY PROVISIONS.

* * * * * * *

Sec. 4. SPECIAL CLASSES OF TAXPAYERS.

"The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estate and trusts and the beneficiaries thereof—Supplement E.

(b) Members of partnerships—Supplement F.

(c) Insurance companies—Supplement G.

(d) Nonresident alien individuals;—etc." (U. S. C. A. Title 26, Sec. 4.)

SUBTITLE B—GENERAL PROVISIONS.

* * * * * * *

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

"Sec. 41. GENERAL RULE.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in

keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (U. S. C. A. Title 26, Sec. 41.)

"Sec. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period" (U. S. C. A. Title 26, Sec. 42).

* * * * * *

"Sec. 48. DEFINITIONS—When used in this title—

"(c) PAID, INCURRED, ACCRUED—The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part" (U. S. C. A. Title 26, Sec. 48).

SUBTITLE C—SUPPLEMENTAL PROVISIONS.

* * * * * *

SUPPLEMENT F—PARTNERSHIPS.

"Sec. 181. PARTNERSHIP NOT TAXABLE. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity (U. S. C. A. Title 26, Sec. 181).

"Sec. 182. TAX OF PARTNERS. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year (U. S. C. A. Title 26, Sec. 182).

"Sec. 183. COMPUTATION OF PARTNERSHIP INCOME. The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual" (U. S. C. A. Title 26, Sec. 183).

* * * * * *

"Sec. 187. PARTNERSHIP RETURNS. Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners" (U. S. C. A. Title 26, Sec. 187).

TREASURY REGULATIONS 86, RELATING TO THE REVENUE ACT OF 1934.

"Art. 42-2. *Income not reduced to possession.*— Income which is credited to th account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which

so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."

* * * * * * *

"Art. 181-1. *Partnerships.*—Partnerships as such are not subject to taxation under the Act, but are required to make returns of income. (See Sections 187 and 188.) For definition of what the term 'partnership' includes, see section 801 (3)."

* * * * * * *

"Art. 182-1. *Distributive share of partners.*—Individuals carrying on business in partnership are taxable upon their distributive shares of the net income of such partnership, whether distributed or not, and are required to include such distributive shares in their returns. The distributive share of the net income of the partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either—

(a) For the taxable year upon the basis of which the partner's net income is computed, or

(b) If the partner's net income is computed upon the basis of a taxable year different from that

upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable year. If the result of partnership operation is a net loss (excess of allowable deductions over gross income), the loss will be divisible by the partners in the same proportion as net income would have been divisible (or, if the partnership agreement provides for the division of a loss in a manner different from the division of a gain, in the manner so provided), and may be taken by the individual partners in their returns of income. If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, that part of his distributive share of the partnership's net income which is community property should be reported by the husband and by the wife in equal proportions. In the case of a partnership closely related to other trades or businesses, see section 45."

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Supreme Court of the United States

OCTOBER TERM 1940

No. 436

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

ESTATE OF JOHN M. ENRIGHT, deceased, JAMES G. ENRIGHT, EMMA E. NEILSON and MILDRED ENRIGHT, executors,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF ON BEHALF OF ESTATE OF CHARLES S. HAIGHT, DECEASED, AS *AMICUS CURIAE*

HAROLD S. DEMING,
Counsel.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF ON BEHALF OF ESTATE OF CHARLES S. HAIGHT, DECEASED, AS *AMICUS CURIAE*

The interest of the Estate of Charles S. Haight, deceased, on behalf of which this brief is filed as *amicus curiae* with the consent of both parties, arises out of the pendency before the Board of Tax Appeals (Docket No. 105,784) of a proceeding involving the same questions as presented in the case before this Court, and set forth at page 2 of the brief for respondents.

No duplication will be made herein of respondents' argument, but there will be put before the Court an additional comment upon Section 42 of the Revenue Act of 1934, together with an additional comment upon *Guaranty Trust*

Company v. *Commissioner*, 303 U. S. 493, and *Bull* v. *United States*, 295 U. S. 247, the two principal cases upon which the Government relies in making its argument, not urged before the Circuit Court of Appeals, that the income computing method of the partnership is not determinative of the distributive share of the deceased partner.

POINT I

Section 42 of the Revenue Act of 1934 does not apply to a partnership.

While Section 42 of the Revenue Act of 1934 puts the *decedent's* final return on the accrual basis, the section does not put on the accrual basis *the return of the law partnership* of which decedent was a member.

The application of Section 42 of the Revenue Act of 1934 by its terms is limited to computing the net income of "a taxpayer". Section 801 of the Revenue Act of 1934 provides:

> "Sec. 801. Definitions.
>
> * * * * * *
>
> (14) The term 'taxpayer' means any person subject to a tax imposed by this Act."

A law partnership is not "subject to a tax" imposed by the Act, and therefore is not "a taxpayer". It follows that Section 42 cannot be held to change the accounting method of such a partnership from the cash to the accrual basis by reason of the death of one of the partners.

Where, therefore, the deceased partner was a member of a partnership which at all times was on a cash basis, the partner (and after his death, his estate) was entitled to no distributive share in the partnership income except as and when received by the partnership. As the partnership accrued no income, no *right* could possibly accrue to the decedent (or his estate) until the corresponding *obligation* of the partnership to him (or his estate) came into being.

POINT II

Neither the *Guaranty Trust Company* case nor the *Bull* case supports the Government's contention that the distributive share of a deceased partner is to be computed otherwise than by the method of accounting used by the partnership.

The Government asserts that the items in suit are "taxable as income earned by him" (the decedent) "during his lifetime under the *Bull* and *Guaranty Trust* cases" (p. 7); and that "it is not material that the decedent's interest ascertained on a final accounting should ever have been distributable to him in his lifetime" (p. 13). The Government's argument purports to be based upon *Guaranty Trust Company* v. *Commissioner*, 303 U. S. 493, and *Bull* v. *United States*, 295 U. S. 247. The distinctions between these two cases and the case at bar have been set forth at pages 6-8 of the brief for respondent. The following additional facts emphasize the distinctions.

Examination of the record in the *Guaranty Trust Company* case shows that the Commissioner determined that the decedent's distributive share of the partnership income earned from July 31, 1933, to the date of his death was $63,494.46. This item of $63,494.46 included the cash earnings of the partnership during the period and also uncollected commissions earned during that period in the sum of $13,894.74 and unreported interest on decedent's credit balance for that period and decedent's capital investment (see findings of fact, 34 B. T. A. 384, at 386). The decedent died on December 16, 1933. Both the decedent and the partnership kept their books and filed their tax returns on a cash basis.

The Board of Tax Appeals held that none of the items—"uncollected commissions", "unreported interest" or the decedent's share of the cash earnings of the partnership from July 31, 1933, to the date of death of the decedent—

were required to be reported in the decedent's final income tax return (34 B. T. A. 390).

When the Commissioner filed his petition for review, he made *no assignment of error* as to the decision of the Board with respect to the "uncollected commissions" and "unreported interest". The case came before the Circuit Court of Appeals, therefore, with these items eliminated.

The Circuit Court of Appeals for the Second Circuit held that the decedent's executors must include the decedent's share of the *cash earnings* of the partnership from July 31, 1933, to the date of decedent's death (89 Fed. [2d] 692).

The argument of the taxpayer before the Circuit Court of Appeals was that the decedent's share of the *cash earnings* of the partnership up to the death of the decedent should not be included in the decedent's final return, because the partnership was on an annual accounting basis and no part was distributable, under the partnership provisions of the statute, until the close of the twelve-month accounting period, i. e., on July 31, 1934. The Circuit Court of Appeals rejected the argument and held that the death of the decedent dissolved the partnership, and that the period from July 31, 1933, to December 16, 1933, must be regarded as an accounting period and that decedent's then *distributive share* was taxable to him. In other words, when the case reached the Circuit Court of Appeals, the only question involved was whether the decedent's executors were required to include the decedent's distributive share of the *cash earnings* of the partnership for the preceding fiscal year, ending on July 31, 1933, *plus* decedent's share of the *cash earnings* of the partnership from July 31, 1933, to the date of decedent's death.

The case reached this Court upon the same issue. The Government's brief in this Court specifically stated, page 6, that the petition for review did not assign error to the uncollected commissions and unreported interest items; and that "the decedent's share of the cash profits of the

partnership for the period from August 1, 1933, to December 16, 1933", was "the only item involved in the court below and is the only item now involved in this Court." It is clear, therefore, that when this Court, in its decision, referred to "income, whenever earned" (p. 498) and "profits accrued on the date of his death" (p. 496), this Court was speaking of *cash earnings* of the *partnership* from July 31, 1933, to the date of the decedent's death, computed in accordance with the method of accounting used *by the partnership;* which, *under such method,* represented the distributive share of the decedent, taxable to him under the terms of Section 182, of the applicable Revenue Act, whether actually distributed or not.

Similarly, in the *Bull* case, the decedent's distributive share of $24,124.20 in partnership profits (*actually received* by the partnership and *credited to the decedent on the accounts* of the partnership prior to the death of decedent) was determined by the method of accounting used *by the partnership.*

While it is true that the opinion of this Court does not state whether the partnership was on a cash or accrual basis or whether it had received payment for the services rendered, the Board of Tax Appeals in *Ernest M. Bull, executor,* v. *Commissioner* (7 B. T. A. 993), dealing with the same taxpayer, the same partnership and the same taxable period as were before this Court, stated (p. 993) with respect to the partnership:

> "Its books were kept on the cash receipts and disbursements basis";

and that

> "The decedent's share in the profits of the partnership which had been earned before his death was $24,124.20. This amount *appeared to his credit on the accounts of the partnership at the date of his death.*" (Italics supplied.)

There is no doubt, therefore, that the $24,124.20 held by this Court to be includable as income to the decedent prior to his death was computed in strict accordance with the method of accounting (cash receipts and disbursements basis) employed *by the partnership.*

It is respectfully submitted that the *Guaranty Trust Company* and the *Bull* cases do not support the Government's contentions that the items in suit are "taxable as income earned by him" (the decedent) "during his lifetime under the *Bull* and *Guaranty Trust* cases"; and that it is "immaterial" whether the deceased partner's interest should ever have been distributable to him during his lifetime. On the contrary, they hold that the final return filed for decedent is to include only the *distributive* share of decedent in "cash earnings" or "profits" of the *partnership* during the period to the death of decedent, as determined by the *accounting method of the partnership.*

In the case at bar, the partnership, on a cash basis, accrued no income, and the decedent at the time of his death was not entitled to any distributive share in the items in suit. To hold otherwise would violate not only the accounting method used by the partnership, but also the partnership agreement.

The decision of the Circuit Court of Appeals for the Third Circuit should be affirmed.

Respectfully,

HAROLD S. DEMING,
Counsel.

APPENDIX

Statute Involved

REVENUE ACT OF 1934, c. 277, 48 STAT. 680:

SUBTITLE B—GENERAL PROVISIONS.

* * * * * * *

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

* * * * * * *

SEC. 42. Period in Which Items of Gross Income Included.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period. (U. S. C. A., Title 26, Sec. 42.)

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SUPREME COURT OF THE UNITED STATES.

No. 436.—October Term, 1940.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Estate of John M. Enright, Deceased, James G. Enright, Emma B. Neilson, and Mildred L. Enright, Executors.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[March 31, 1941.]

Mr. Justice Reed delivered the opinion of the Court.

Certiorari was granted to review the judgment below[1] because of a conflict between it and *Pfaff* v. *Commissioner*[2] in the Second Circuit. The issue is whether § 42 of the Revenue Act of 1934[3] permits the inclusion, as accruable items, in a decedent's gross income for the period ending with his death of his share of the profits earned, but not yet received, of a partnership, when both the decedent and the partnership reported income on a cash receipts and disbursements basis.

Respondents are the executors of John M. Enright, an attorney and member of a law partnership in New Jersey. Both Mr. Enright and his firm kept their accounts and made their income tax report on a calendar year cash receipts and disbursements basis. He died, testate, November 19, 1934. The partnership agreement provided for the termination of the partnership on the death of any partner and that his estate should have his partnership percentage in the

[1] 112 F. (2d) 919.

[2] 113 F. (2d) 114. See Pfaff v. Commissioner, No. 479 this Term, decided today.

[3] 48 Stat. 680, c. 277: "Sec. 42. Period in which Items of Gross Income Included. The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

"net monies then in the treasury of the firm, plus his like percentage in the outstanding accounts and the earned proportion of the estimated receipts from unfinished business." The will directed that the valuation for the purpose of closing out the partnership should be made by his senior surviving partner, Mr. James D. Carpenter, and by agreement between Mr. Carpenter and the executors a valuation was made of these items as of the date of death for use in the Federal estate tax and New Jersey inheritance tax returns, with the further understanding that the surviving partners would pay over to the executors whatever was ultimately realized out of the valued assets.

Pursuant to this arrangement the interest of Mr. Enright in the uncollected accounts was valued at $2,055.55 and in the unfinished work at $40,855.77. These sums were reported as assets in the estate and inheritance tax returns but were not included in the income tax return made for the decedent for 1934 nor were the sums derived from these assets reported in the estate's income tax for 1934 or later years.

The Commissioner assessed a deficiency because he included in the decedent's return for 1934, under the claimed authority of § 42, *supra* note 3, the items of accounts and unfinished work. Respondents appealed to the Board of Tax Appeals. The Board decided[4] that the evidence did not show the situation of the unfinished work in sufficient detail to enable the Board to determine independently that it was not accruable. The accounts receivable were held accruable. This left the Commissioner's assessment intact.

On appeal the Circuit Court of Appeals reversed the Board. It was of the opinion that the partnership was a tax computing unit separate from its members and that § 42 had the effect of placing the decedent "upon an accrual basis at the date of his death." Consequently his return should be made as it would have been made if the deceased used the accrual method. The Court then reasoned that the requirement of § 182 of the Revenue Act of 1934, including a partner's distributive share of the partnership earnings, whether distributed or not, in the partner's computation of his own net income, put a partner on an accrual basis in accounting for partner-

[4] August 28, 1939, by memorandum opinion. Cf. Lillian O. Fehrman, Executrix, 38 B. T. A. 37.

ship earnings, irrespective of § 42. Consequently § 42 was held not to affect the partnership accounting practices. It was further determined that it was the right to receive payment which made an earning accrue and that as Mr. Enright under the partnership agreement had no right to receive anything from the firm except his proportionate share of the cash receipts, these cash receipts were all that "accrued" to him before his death.

The last sentence of § 42 which requires the inclusion of "amounts accrued up to the date of his death" in computing net income for the period in which his death falls was added by the 1934 Revenue Act.[5] The reports recommended its addition because the "courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether."[6] So § 42 was drawn to require the inclusion of all amounts accrued to the date of death "regardless of the fact that he may have kept his books on a cash basis."[7] With the declared purpose of Congress in mind, we proceed to examine the meaning of the section.

As the questioned items of unfinished work appear in the partnership accounts, we must determine whether such earnings, even if accruable, are includible in the partner's return for 1934. Respondent argues, as the Circuit Court of Appeals held, that § 182[8] accrues, without any effect from the language of § 42, all the earn-

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[5] Cf. Revenue Act of 1932, 47 Stat. 169, c. 209, § 42.

[6] H. Rep. No. 704, 73rd Cong., 2nd Sess., p. 24; S. Rep. No. 558, 73rd Cong., 2nd Sess., p. 28.

This situation followed the decision of the Court of Claims in Nichols *v.* United States, 64 Ct. Cl. 241. A decedent on the cash basis was a member of a partnership dissolved by his death. Commissions earned before death but unpaid to the partnership were valued in the estate tax and collected by the partnership after death for payment to the executors. The Court of Claims held sums paid the executors were part of the corpus and not income.

The Board of Tax Appeals followed the reasoning of the Court of Claims. William G. Frank, Adm., 6 B. T. A. 1071; E. S. Heller, Exec., 10 B. T. A. 53; George Nichols et al., Exec., 10 B. T. A. 919; Estate of A. Plumer Austin, 10 B. T. A. 1055; William K. Vanderbilt, Exec., 11 B. T. A. 291; J. Howland Auchincloss, Exec., 11 B. T. A. 947; William P. Blodget et al., Exec., 13 B. T. A. 1243; Jackson B. Kemper, Adm., 14 B. T. A. 931; Maurice L. Goldman, 15 B. T. A. 1341.

[7] H. Rep. *supra.*

[8] "SEC. 182. Tax of Partners. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year."

ings that are includible in a partner's return, and that since the partnership method of keeping its books did not treat unfinished business as receipts, only the earnings actually collected are a part of the partner's distributive share under § 182.

We think such a conclusion is erroneous. The partnership agreement and the subsequent arrangement between the executors and the surviving partners called for a valuation on Mr. Enright's death and a dissolution as of that day. This necessitated an accounting of partnership earnings for this period. By the terms of the agreement, as would have been necessary anyway, the earned proportion of the unfinished business was to be valued to determine the decedent's interest in the partnership assets.[9] Assuming at this point that the unfinished business is accruable, this accounting as of the time of death would show the partnership income for the taxable year of the partnership.[10] As the net income of the partnership is to be accounted for in the deceased partner's return, without consideration of the period over which the income is earned, the fact that the payment for the unfinished business will not be collected until another taxable year is immaterial. "Circumstances wholly fortuitous may determine the year in which income, whenever earned, is taxable."[11] The "distributive share" referred to in § 182 does not mean available in cash for payment to the partner. It means only that gains attributable to the partner's interest in the firm were earned. Partnership returns may be made on a different basis of computation than those of the members.[12] Thus because of the

[9] We do not consider or decide whether this accounting for a fractional year may affect the individual returns of surviving partners. Neither do we appraise the effect of agreements for continuation of an interest in the partnership after death. See Bull *v.* United States, 295 U. S. 247.

If the partnership had been upon an accrual basis which treated accounts as accrued upon a determination of the amount of fees, it may be that a decedent's interest would not be distributable until a later year. It might then be income to the estate, even though the value of the right to receive it was included in the estate return. A conclusion as to this is unnecessary and is pretermitted. Cf. note 23, the cases cited in note 6 and Bull *v.* United States, 295 U. S. 247, 255, 256-57.

[10] "SEC. 48. Definitions. When used in this title—

(a) Taxable Year.—'Taxable year' means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. 'Taxable year' includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made."

[11] Guaranty Trust Co. *v.* Comm'r., 303 U. S. 493, 498.

[12] Truman *v.* United States, 4 F. Supp. 447; §§ 183 and 187.

partnership arrangement and agreement, the value of the unfinished business must be determined as of the date of death. Further the result, under the assumption here that it is an accrual, is a distributive share and is to be carried into the partner's return. Respondent's argument that the requirement of § 182, including all distributable shares in the partner's return, puts all partnership returns on the accrual basis fails to give weight to the fact that a partnership on the cash method shows only cash receipts as a partner's distributive share. The requirement to account for a distributive share, although the share is actually not distributed, is not a requirement to account for partnership income on an accrual basis. Since a partner's return of his partnership earnings would vary, dependent upon whether the partnership used the cash or accrual method of accounting, we do not agree with respondent's suggestion.

We turn now to whether this valuation of the decedent's interest in the partnership is an accrual of income which must be reflected in the income tax or a valuation of assets only reflected in estate or inheritance reports. This partnership uses the cash receipts method. There was no customary accounting system to determine whether the value of services rendered should be accrued before payment. Under such circumstances, we are of the view that items of partnership income properly accrued should be included in the income tax return of the deceased partner. This will cause the accrued items of partnership returns to be included in the income tax return of a deceased partner, whether the partnership method is accrual or cash.[13] Furthermore, an accrual of compensation for the unfinished business seems sound in view of the purpose of the enactment of § 42.

The meaning of "amounts accrued up to the date of his death" is clear as to fixed rent, interest, salary or wages for personal services and other similar income which may readily be attributed to a particular period. There are like deductions such as interest and taxes.[14] The uncertainty as to the meaning arises in the field of personal service from items which cannot be accounted for on a basis of successive equal units of time. Examples of the difficulty

[13] The inevitable variations of "accrued" which depend upon established accounting practice do not destroy the principle.

[14] Cf. United States v. Anderson, 269 U. S. 422.

are the value, prior to a successful result, of services rendered on a contingent basis, done on a quantum meruit whether that would or would not vary with the outcome, or exploratory or preliminary steps looking towards final accomplishment.

While "accrue" and its various derivatives are not new to the nomenclature of accounting or taxation, its use has not sufficed to build it into a word of art with a definite connotation when employed in describing items of gross income. The 1913 Act[15] put the taxpayer on an actual cash receipt and disbursement basis. The 1916 Act[16] gave the taxpayer the option of reporting on either the cash or accrual basis and the 1918 Act limited the return to the method of accounting regularly employed unless otherwise directed by the Commissioner of Internal Revenue.[17] A similar provision covers the year here in question.[18] That the meaning to be attributed to "accrued" as used in § 42 is to be gathered from its surroundings is emphasized by § 48, Definitions, which says:

"(c) Paid, incurred, accrued.—The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part."[19]

It is to be noted that no change was made by the 1934 Act in the § 48 definition of "accrued."[20] Yet, it is obvious that the definition is inapplicable since a taxpayer on a cash basis cannot have a "method of accounting" by which the meaning of accrual is fixed. Consequently it is beside the point to give weight to provisions of the regulations or accounting practices which do not recognize accruals until a determination of compensation.[21] Such provisions when applied bring the income into succeeding years. It has been frequently said, and correctly, that § 42 was aimed at putting the cash receipt taxpayer on the accrual basis.[22] But that statement

15 38 Stat. 114 at 166.

16 39 Stat. 756, §§ 8(g) and 13(d).

17 40 Stat. 1057, § 212(b).

18 48 Stat. 680, § 42.

19 Cf. Ernest M. Bull, Exec., 7 B. T. A. 993, 995.

20 Cf. § 48(c) of the Revenue Act of 1932, 47 Stat. 188.

21 Regulation 86, Art. 42-1.

22 Lillian O. Fehrman, Exec., 38 B. T. A. 37; Estate of Wilton J. Lambert, 40 B. T. A. 802, 806; Estate of G. Percy McGlue, 41 B. T. A. 1186, 1193; Enright *v.* Commissioner, 112 F. (2d) 919, this case below.

does not answer the meaning of accrual in this section. Accounts kept consistently on a basis other than cash receipts might treat accruals quite differently from a method designed to reflect the earned income of a cash receipt taxpayer. Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns. Congress sought a fair reflection of income.[23]

Accrued income obviously connotes more than interest. In *United States* v. *American Can Company*,[24] this Court approved an accrual basis where "pecuniary obligations to or by the Company were treated as if discharged when incurred." In *United States* v. *Anderson*[25] accruals of fixed annual charges, e. g., taxes payable in another year, were permitted against determinable gross income. "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income."[26] The completion of the work in progress was necessary to fix the amount due but the right to payment for work ordinarily arises on partial performance. Accrued income under § 42 for uncompleted operations includes the value of the services rendered by the decedent, capable of approximate valuation whether based on the agreed compensation or on quantum meruit. The requirement of valuation comprehends the elements of collectibility.[27] The items here meet these tests and are subject to accrual.

The judgment of the Circuit Court of Appeals is reversed and the decision of the Board of Tax Appeals affirmed.

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[23] It is immaterial that all possibility of escaping an income tax is not barred, as for instance the increased value of asset items in an estate return. Act, 113(a)(5) " . . . the entire field of proper legislation [need not] be covered by a single enactment." Rosenthal *v.* New York, 226 U. S. 260, 271; cf. Keokee Coke Co. *v.* Taylor, 234 U. S. 224, 227.

[24] 280 U. S. 412, 417.

[25] 269 U. S. 422, 437.

[26] Spring City Co. *v.* Commr., 292 U. S. 182, 184; Guaranty Trust Co. *v.* Commr., 303 U. S. 493, 498.

[27] Cf. Parlin, Accruals to Date of Death, 87 U. of Pa. L. Rev. 294, 301; Farrand & Farrand, Treatment of Accrued Items on Death, 13 So. Cal. L. Rev. 431.